

**CITY OF HUNTSVILLE
ELECTRIC, NATURAL GAS,
AND WATER SYSTEMS**

**COMPONENT UNIT
FINANCIAL STATEMENTS**

SEPTEMBER 30, 2010 AND 2009

CONTENTS

MANAGEMENT DISCUSSION AND ANALYSIS	Page 1
INDEPENDENT AUDITOR'S REPORT	8
CITY OF HUNTSVILLE ELECTRIC SYSTEM (a component unit)	
Statement of Net Assets	9
Statement of Revenue, Expenses and Changes in Net Assets	11
Statements of Cash Flows	12
CITY OF HUNTSVILLE GAS SYSTEM (a component unit)	
Statement of Net Assets	14
Statement of Revenue, Expenses and Changes in Net Assets	16
Statement of Cash Flows	17
CITY OF HUNTSVILLE WATER SYSTEM (a component unit)	
Statement of Net Assets	19
Statement of Revenue, Expenses and Changes in Net Assets	21
Statement of Cash Flows	22
COMBINED NOTES TO THE COMPONENT UNIT FINANCIAL STATEMENTS	24

Overview of the Financial Statements

The annual report includes this management's discussion and analysis report, the independent auditor's report and the basic financial statements of the Utilities. The financial statements also include notes that explain in more detail some of the information in the financial statements.

Required Financial Statements

The Huntsville Utilities are comprised of three separate operating Systems. Where practical and cost effective, they share common functions and each System pays a pro-rata share of those expenses. As each System must support its operations through its own sales revenues and fees, there are three sets of financial statements enclosed. The financial statements of the Utilities report information using accounting methods similar to those used by private sector companies. Generally Accepted Accounting Principles (GAAP), however, are set by the Governmental Accounting Standards Board (GASB), not the FASB as the private sector. The industry as a whole is a regulated industry that follows the Federal Energy Regulatory Commission (FERC) mandates. The Huntsville Electric System's regulatory body is the Tennessee Valley Authority which has adopted most of these directives as published in the Federal Code of Regulations Title 18. These statements offer short and long term financial information about their activities. The Balance Sheet include all of the individual System's assets and liabilities and provide information about the nature and amounts of investments in resources (assets) and the obligations to creditors (liabilities). It also provides the basis for evaluating the capital structure of the System and assessing the liquidity and financial flexibility of the System.

All of the current year's revenues and expenses are accounted for in the Statements of Revenues, Expenses, and Changes in Net Assets. These statements measure the success of the System's operations over the past year and can be used to determine whether the System has successfully recovered all its costs through its rates and fees, profitability and credit worthiness.

The final required financial statements are the Statements of Cash Flows. The statements report cash receipts, cash payments, and net changes in cash resulting from operations, investing and financing activities and provide answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balances during the reporting period.

City of Huntsville Electric System
Table A-1
Condensed Balance Sheet
(000's)

	FY 2010	Restated FY 2009	\$ Change
Current and Other Assets	\$ 124,341	\$ 112,798	\$ 11,543
Capital Assets (Net)	248,036	241,695	6,340
Total Assets	\$ 372,377	\$ 354,493	\$ 17,883
Current and Other Liabilities	\$ 132,278	\$ 83,467	\$ 48,811
Long-Term Liabilities	19,207	48,942	(29,735)
Total Liabilities	\$151,485	\$ 132,409	\$ 19,076
Invested in capital assets-net of long term debt	\$ 227,731	\$ 219,921	\$ 7,810
Restricted assets	6,918	6,853	65
Unrestricted assets	(13,757)	(4,689)	(9,068)
Total Net Assets	\$220,892	\$ 222,085	\$ (1,193)
Total Liabilities and Net Assets	\$ 372,377	\$ 354,494	\$ 17,883

The old IBM legacy Billing and CIS System (Phase II) are scheduled for replacement during FY 2010 – 2011 by the new SAP software installation. This conversion was planned for and required no additional debt. The Board has allocated sufficient funds to pay for this conversion from Renewal and Replacement Funds. This was a reduction in Renewal and Replacement Funds of \$9.4 million. There remains \$3.1 million in the fund. The replaced software and remaining Billing and CIS system is a 30 year-old legacy system whose language and operating system are no longer supported.

Our available cash position exceeds the Board's desired minimum of 45 days of budgeted operating and capital expenses by \$15.8 million.

The Electric System has been notified of Unbilled contract payments by TVA for the years 2004 to 2010. The adjustments increase the cost of power for each of the years. An adjustment to Beginning Net Assets of \$22,220,859 was made restating the previous balance. Power costs were increased by \$6,022,618 for the year ending 2009, which reduced net income for the year by the same amount. The balance of the outstanding Unbilled contract payables was \$35,272,375 at September 30, 2010.

City of Huntsville Electric System
Table A-2
Condensed Statement of Revenues, Expenses and
Changes in Net Assets
(000's)

	FY 2010	Restated FY 2009	\$ Change
Operating Revenues	\$456,705	\$451,207	\$5,498
Non-Operating Revenues	437	591	(154)
Total Revenues	\$457,142	\$451,798	\$5,344
Operating Expense	\$430,170	\$425,210	\$4,960
Depreciation Expense	14,528	12,320	2,208
Non-Operating Expense	1,873	2,688	(815)
Total Expenses	\$446,571	\$440,218	\$6,353
Income (Loss) Before Transfers	\$ 10,571	\$ 11,579	\$ (1,009)
Transfers Out – Tax Equivalents	(11,764)	(10,595)	(1,169)
Change in Net Assets	\$ (1,193)	\$ 984	\$(2,178)
Beginning Net Assets	222,085	243,322	(21,237)
Prior Period Adjustment	0	(22,221)	22,221
Ending Net Assets	\$220,892	\$222,085	\$(1,193)

The change in Operating Revenues was an increase of \$5.5 million (+1.2%) due to the increase in Kilowatt hour sales and the lowering of TVA's wholesale quarterly fuel cost adjustments (FCA's). Kilowatt hour sales increased by 10.5%. The System experienced a colder than normal winter period. Extreme summer temperatures were higher than FY2009. Our customer growth for the area moderated to 1.1% this year with a definite lull in the Base Realignment and Closure Act (BRAC) relocation. Huntsville's Redstone Arsenal is the beneficiary of base closures in other parts of the country with complete Commands being relocated here. Growth should be increasingly active as BRAC has a legal deadline to be complete in September of 2011. We have been shielded from the worst effects of the economy's downturn due to our diversity in industry and the continued strength of our core businesses. Non-Operating Revenues declined \$154 thousand due to the falling interest rates (which have become next to nonexistent) lowering the income on reserves and cash on hand.

Operating Expense increased \$5.0 million, \$4.9 million of which was for wholesale power from TVA. The average cost of kWh purchased decreased from 7.71 cents (\$0.0771) in FY2009 to 7.07 cents (\$0.0707) in FY 2010. Purchases of kWh increased by 10.5%. Depreciation Expense increased \$2.2 million due to numerous capital projects being completed and placed in service.

The Electric System has been notified of Unbilled contract payments by TVA for the years 2004 to 2010. The adjustments increase the cost of power for each of the years. Power costs were increased by \$7,028,898 and \$6,022,618 for the years ending 2010 and 2009, which reduced net income for the years by the same amount.

City of Huntsville Gas System
Table B-1
Condensed Balance Sheet
(000's)

	FY2010	FY2009	\$ Change
Current and Other Assets	\$46,132	\$43,871	\$2,261
Capital Assets (Net)	93,502	84,924	8,578
Total Assets	\$139,634	\$128,795	\$10,839
Long-Term Debt Outstanding	\$8,520	\$8,975	(\$455)
Other Liabilities	14,059	12,767	1,292
Total Liabilities	\$22,579	\$21,742	\$837
Invested in Capital Assets, Net of Related Debt	\$84,645	\$75,638	\$9,007
Restricted	13,212	3,029	10,183
Unrestricted	19,198	28,386	(9,188)
Total Net Assets	\$117,055	\$107,053	\$10,002
Total Liabilities and Net Assets	\$139,634	\$128,795	\$10,839

While not tracing dollar for dollar the actual movement between Balance Sheet categories, the simple net result of the changes to the Balance Sheet are as follows: Current and Other Assets show an increase of \$2.3 million while at the same time Other Liabilities show an increase of \$1.3 million. Invested in Capital Assets, Net of Related Debt increased \$9 million as we generated a net income of \$10.0 million.

In the Gas System, finances are extremely dependent on weather conditions out of the System's control. Income is only made in the winter months that must carry the System through the entire year. If there is a very mild winter, there is no summer season that may aid in the year's recovery as in the Electric department. Additionally, the Board desires to maintain approximately \$10 million in available funds. At September 30, 2010 available funds, including reserves, stood at \$33.1 million, \$2.5 of which was segregated in a Rate Stabilization Fund.

The Gas Board desires to maintain approximately \$10.0 million in reserves due to the possibility of extreme fluctuations in wholesale gas prices and retail gas usage. The Board currently has over \$27.0 million in the reserve buffer. The Gas System currently has adequate reserves to meet its future Operating and Capital requirements.

City of Huntsville Gas System
Table B-2
Condensed Statement of Revenues, Expenses and
Change in Net Assets
(000's)

	FY2010	FY2009	\$ Change
Operating Revenues	\$63,025	\$63,412	(\$387)
Non-Operating Revenues	159	655	(496)
Total Revenues	\$63,184	\$64,067	(\$883)
Depreciation Expense	\$2,926	\$2,548	\$378
Operating Expense	46,471	53,183	(6,712)
Non-Operating Expense	552	477	75
Total Expenses	\$49,949	\$56,208	(\$6,259)
Income(Loss) Before Contributions and Transfers	\$13,235	\$7,859	\$5,376
Capital Contributions	325	441	(\$116)
Transfers Out - Tax Equivalents	(3,557)	(3,573)	16
Change in Net Assets	\$10,003	\$4,727	\$5,276
Beginning Net Assets	\$107,053	\$102,326	\$4,727
Ending Net Assets	\$117,056	\$107,053	\$10,003

Operating Revenues decreased by \$387 thousand reflecting a 11.5% rate reduction net of 13.1% increase in MCF sold.

Operating Expense decreased by \$6.7 Million. The price of natural gas delivered was \$8.10 an MCF compared to \$10.37 for 2009. This decrease accounted for \$6.3 million of the Operating Expense decrease even with a 10.0% increase in Purchased Gas. Total Revenues decreased \$883 thousand.

An independent Gas Cost of Service study was performed in 2009 and for FY 2010 the Customer Charge was increased by \$2.00 increasing the Gas Cash Flow by approximately \$1,000,000 a year regardless of the cost of gas or weather conditions.

City of Huntsville Water Works
Table C-1
Condensed Balance Sheet
(000's)

	FY2010	FY2009	\$ Change
Current and Other Assets	\$38,450	\$33,097	\$5,353
Capital Assets (Net)	161,783	163,873	(2,090)
Total Assets	\$200,233	\$196,970	\$3,263
Long-Term Debt Outstanding	\$38,785	\$40,905	(\$2,120)
Other Liabilities	11,266	12,750	(1,484)
Total Liabilities	\$50,051	\$53,655	(\$3,604)
Invested in Capital Assets Net of Related Debt	\$120,191	\$120,173	\$18
Restricted	13,635	18,776	(5,141)
Unrestricted	16,356	4,366	11,990
Total Net Assets	\$150,182	\$143,315	\$6,867
Total Liabilities and Net Assets	\$200,233	\$196,970	\$3,263

Current and Other Assets increased by \$5.4 million. This was a combination of a increase in Cash and Cash Equivalents of \$11.6 million which is due to the sale of a building for \$6.8 million and the expenditure of bond generated Construction Funds in the amount of \$5.2 million. During FY 2010 the expansion of the Eastern Loop Water Plant was completed. This strengthened the System in a fast growing part of the County. Our Capital Assets, Net of Related Debt decreased \$2 million due to increases in construction work in process (\$ 5.7 million) and the sale of a building (\$6.8 million).

The Board desires to maintain approximately 45 days of Operating and Capital Expenses as determined by the current budget. The Water System currently has adequate reserves to meet its future Operating and Capital requirements.

City of Huntsville Water Works

Table C-2

Condensed Statement of Revenues, Expenses and Change in Net Assets

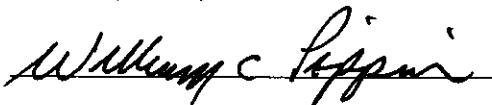
(000's)

	FY2010	FY2009	\$ Change
Operating Revenues	\$25,328	\$25,131	\$197
Non-Operating Revenues	71	78	(7)
Total Revenues	\$25,399	\$25,209	\$190
Depreciation Expense	\$5,616	\$4,847	\$769
Operating Expense	15,941	15,566	375
Non-Operating Expense	(415)	1,035	(1,450)
Total Expenses	\$21,142	\$21,448	(\$306)
Income(Loss) Before Contributions and Transfers	\$4,257	\$3,761	\$496
Capital Contributions	3,947	4,719	(772)
Transfers Out - Tax Equivalents	(1,338)	(1,358)	20
Change in Net Assets	\$6,866	\$7,122	(\$256)
Beginning Net Assets	\$143,316	\$136,194	\$7,122
Ending Net Assets	\$150,182	\$143,316	\$6,866

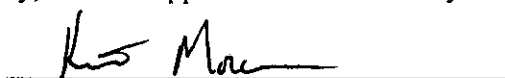
Gallons sold increased by 169 million gallons which was a 1.5% increase in total volume of sales from the previous year. Sales revenues increased by .08%.

Operating Expense increased by \$375 thousand. Most of this increase was in Maintenance of the Distribution System.

Capital Contributions decreased this year by \$617 thousand as the area construction cooled somewhat with the general economy. It will pick up again as we enter the final year of the Base Realignment and Closure (BRAC) with several thousand military, civilian support staff and families yet to come.



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Keith Moran, Controller

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INDEPENDENT AUDITOR'S REPORT

City of Huntsville
Electric, Natural Gas and Water Boards
Huntsville, Alabama

We have audited the accompanying statements of net assets of the City of Huntsville Electric, Natural Gas and Water Systems (the Utilities), a component unit of the City of Huntsville, Alabama, as of September 30, 2010, and the related statements of revenue, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Utilities' management. Our responsibility is to express an opinion on these financial statements based on our audit. The September 30, 2009 financial statements were examined by other auditors whose report dated January 11, 2010 expressed an unqualified opinion on those financial statements.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of Huntsville Electric, Natural Gas, and Water Systems, as of September 30, 2010, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 1 through 7 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Mercer & Associates, PC

March 28, 2011

**CITY OF HUNTSVILLE ELECTRIC SYSTEM
STATEMENTS OF NET ASSETS
SEPTEMBER 30, 2010 AND 2009**

ASSETS

	<u>2010</u>	<u>Restated 2009</u>
Current Assets		
Cash and cash equivalents	\$ 51,951,785	\$ 48,029,835
Accounts receivable - trade, net of allowance for doubtful accounts of \$301,450 in 2010 and \$301,450 in 2009	36,707,444	24,636,043
Materials and supplies	5,711,435	5,512,652
Prepaid expenses	14,586	8,499
Accrued interest, rent and other receivables	3,030,838	2,417,552
Total Current Assets	<u>97,416,088</u>	<u>80,604,581</u>
 Restricted and Board Designated Assets (Note 1)		
Emergency Funds - Designated	3,000,000	3,000,000
Insurance Funds - Designated	1,253,398	1,042,233
Construction Funds - Designated	11,726,914	11,326,914
Renewal & Replacement Funds - Designated	3,109,364	8,869,104
Other special funds - Restricted	271,691	251,712
Improvement Funds - Bond Restricted	500,000	500,000
Debt Service Funds - Bond Restricted	1,573,718	1,668,629
Reserve Debt Service Funds - Bond Restricted	2,705,428	2,705,428
Worker's Compensation Funds - Restricted	2,139,489	1,978,709
Total Restricted Assets and Designated Assets	<u>26,280,002</u>	<u>31,342,729</u>
 Deferred Charges		
Unamortized bond expense (Note 5)	644,846	722,592
Other deferred charges	0	128,100
Total Deferred Charges	<u>644,846</u>	<u>850,692</u>
 Utility Plant (Note 1)		
Plant in service	423,392,848	408,185,709
Construction in progress	9,975,346	4,227,892
Retirement work in process	0	0
	<u>433,368,194</u>	<u>412,413,601</u>
Less: Accumulated depreciation	(185,332,593)	(170,718,406)
Total Utility Plant	<u>248,035,601</u>	<u>241,695,195</u>
 TOTAL ASSETS	 <u>\$ 372,376,537</u>	 <u>\$ 354,493,197</u>

The accompanying notes and independent auditor's report are an integral part of these financial statements.

**CITY OF HUNTSVILLE ELECTRIC SYSTEM
STATEMENTS OF NET ASSETS
SEPTEMBER 30, 2010 AND 2009**

NET ASSETS AND LIABILITIES

	<u>2010</u>	<u>Restated 2009</u>
Current Liabilities		
Accounts payable - trade	\$ 43,719,627	\$ 33,676,955
Accounts payable - other utility departments (Note 1)	7,451,361	8,051,906
Customer meter deposits, including accrued interest of \$11,088,324 in 2010 and \$10,948,731 in 2009	37,552,555	35,454,623
TVA contract payable (Note 13)	35,272,375	0
Compensated absences	3,645,596	3,359,759
Other current liabilities	2,893,202	996,851
Total Current Liabilities	<u>130,534,716</u>	<u>81,540,094</u>
 Liabilities Payable from Restricted Assets		
Current maturities of long-term debt (Note 5)	1,455,000	1,615,000
Interest payable	288,245	311,158
Total Liabilities Payable from Restricted Assets	<u>1,743,245</u>	<u>1,926,158</u>
 Long-Term Debt (Note 5)		
Electric revenue bonds, excluding current portion	19,165,000	20,620,000
TVA Contract payable (Note 13)	0	28,243,477
Unamortized bond premium	191,019	264,012
Less: Unamortized debt retirement	(149,368)	(185,206)
Total Long-Term Debt	<u>19,206,651</u>	<u>48,942,283</u>
Total Liabilities	<u>151,484,612</u>	<u>132,408,535</u>
 Net Assets		
Invested in capital assets, net of related debt	227,730,550	219,920,923
Restricted	6,918,634	6,852,766
Unrestricted	(13,757,259)	(4,689,027)
Total Net Assets	<u>220,891,925</u>	<u>222,084,662</u>
TOTAL NET ASSETS AND LIABILITIES	<u>\$ 372,376,537</u>	<u>\$ 354,493,197</u>

The accompanying notes and independent auditor's report are an integral part of these financial statements.

**CITY OF HUNTSVILLE ELECTRIC SYSTEM
STATEMENTS OF REVENUE, EXPENSES, AND
CHANGES IN NET ASSETS
FOR YEARS ENDED SEPTEMBER 30, 2010 AND 2009**

	2010	Restated 2009
Operating Revenue		
Residential	\$ 223,326,418	\$ 213,186,111
Large commercial and industrial	183,483,896	183,397,099
Small commercial	34,441,944	38,784,824
Public street and highway lighting	4,098,340	4,329,390
Other operating revenue	11,354,752	11,509,253
Total Operating Revenue	456,705,350	451,206,677
Operating Expenses		
Purchased power	398,058,964	393,164,943
Transmission	219,286	134,446
Distribution	16,315,725	15,947,793
Customer accounting	4,310,958	4,340,911
Administrative and general	10,043,519	10,471,930
Depreciation	14,528,405	12,320,334
Payroll taxes	1,221,722	1,150,401
Total Operating Expenses	444,698,579	437,530,758
Operating Income	12,006,771	13,675,919
Other Revenue and (Expenses)		
Interest income	437,243	591,075
Interest expense	(1,740,099)	(2,609,943)
Amortization of bond discount	(205,846)	(77,746)
Amortization of bond premium	72,992	0
Total Other Revenue (Expenses)	(1,435,710)	(2,096,614)
Change in Net Assets before Transfers	10,571,061	11,579,305
Transfers Out - Tax Equivalent	(11,763,798)	(10,595,126)
Change in Net Assets	(1,192,737)	984,179
Beginning Net Assets	222,084,662	243,321,342
Prior Period Adjustment (Note 13)	0	(22,220,859)
Ending Net Assets	\$ 220,891,925	\$ 222,084,662

The accompanying notes and independent auditor's report are an integral part of these financial statements.

**CITY OF HUNTSVILLE ELECTRIC SYSTEM
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 2010 AND 2009**

	<u>2010</u>	<u>Restated 2009</u>
CASH FLOWS FROM (USED FOR) OPERATING ACTIVITIES		
Received from customers	\$ 444,633,949	\$ 453,467,195
Paid to suppliers for goods and services	(396,067,960)	(404,606,051)
Paid to employees for goods and services	<u>(14,133,387)</u>	<u>(14,042,912)</u>
Net cash flows from (used for) operating activities	<u>34,432,602</u>	<u>34,818,232</u>
CASH FLOWS FROM (USED FOR) NONCAPITAL FINANCING ACTIVITIES		
Transfers out - tax equivalent	<u>(11,763,798)</u>	<u>(10,595,126)</u>
Net cash provided from (used for) noncapital financing activities	<u>(11,763,798)</u>	<u>(10,595,126)</u>
CASH FLOWS FROM (USED FOR) INVESTING ACTIVITIES		
Change in other assets	0	(77,746)
Interest income earned on investments	<u>437,243</u>	<u>590,880</u>
Net cash provided (used for) from investing activities	<u>437,243</u>	<u>513,134</u>
CASH FLOWS FROM (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES		
Payment of principal on long-term debt	(1,615,000)	(1,509,163)
Retirement of long-term debt	0	0
Proceeds	0	0
Bond issue costs	0	0
Change in deferred charges	0	0
Additions to plant in service	(20,868,812)	(30,227,695)
Changes in special funds, net	5,062,727	7,239,540
Interest paid	<u>(1,763,012)</u>	<u>(2,609,943)</u>
Net cash from (used for) capital and related financing activities	<u>(19,184,097)</u>	<u>(27,107,261)</u>
INCREASE (DECREASE) IN CASH	3,921,950	(2,371,021)
CASH AT BEGINNING OF YEAR	<u>48,029,835</u>	<u>50,400,856</u>
CASH AT END OF YEAR	<u>\$ 51,951,785</u>	<u>\$ 48,029,835</u>

The accompanying notes and independent auditor's report are an integral part of these financial statements.

**CITY OF HUNTSVILLE ELECTRIC SYSTEM
STATEMENTS OF CASH FLOWS - CONTINUED
FOR THE YEARS ENDED SEPTEMBER 30, 2010 AND 2009**

	<u>2010</u>	<u>Restated 2009</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH		
 FLOWS FROM OPERATING ACTIVITIES		
Operating Income	\$ 12,006,771	\$ 13,675,919
Adjustments to reconcile operating income to net cash flows from operating activities:		
Depreciation and amortization included in operating	14,564,243	13,656,835
Change in accounts receivable - customer	(12,071,401)	2,260,518
Change in accounts receivable - other	(613,286)	85,033
Change in inventory	(198,783)	(474,746)
Change in prepaid expenses	(6,087)	325,544
Change in accounts payable	9,442,127	(2,242,777)
Change in TVA contract payable	7,028,898	6,022,618
Change in customer deposits	2,097,932	2,282,956
Change in accrued expenses and other current liabilities	2,182,188	(773,668)
Net Adjustments	<u>22,425,831</u>	<u>21,142,313</u>
NET CASH FLOWS FROM OPERATING ACTIVITIES	<u>\$ 34,432,602</u>	<u>\$ 34,818,232</u>

The accompanying notes and independent auditor's report are an integral part of these financial statements.

**CITY OF HUNTSVILLE GAS SYSTEM
STATEMENTS OF NET ASSETS
SEPTEMBER 30, 2010 AND 2009**

ASSETS

	<u>2010</u>	<u>2009</u>
Current Assets		
Cash and cash equivalents	\$ 20,906,611	\$ 14,878,268
Accounts receivable - trade, net of allowance for doubtful accounts of \$54,594 in 2010 and \$54,594 in 2009	650,851	1,069,466
Stored gas	6,093,906	8,590,759
Materials and supplies	1,084,308	1,135,290
Prepaid expenses	735	116
Accrued interest, rent and other receivables	911,655	1,294,948
Total Current Assets	<u>29,648,066</u>	<u>26,968,847</u>
 Restricted Assets and Board Designated Assets		
Insurance Funds - Designated	997,670	997,670
Construction Funds - Designated	6,959,413	6,360,663
Renewal & Replacement Funds - Designated	2,754,489	3,823,318
Rate Stabilization - Designated	2,500,000	2,500,000
Construction Funds - Restricted	0	0
Debt Service Funds - Restricted	818,244	818,244
Bond Sinking Funds - Restricted	136,269	136,177
Worker's Compensation Fund - Restricted	2,139,017	2,074,543
Restricted Assets and Designated Assets	<u>16,305,102</u>	<u>16,710,615</u>
 Other Assets		
Unamortized debt expense	<u>179,296</u>	<u>191,383</u>
 Utility Plant (Note 1)		
Plant in service	135,833,172	124,502,336
Construction in progress	<u>1,378,594</u>	<u>993,341</u>
	137,211,766	125,495,677
Less: Accumulated depreciation	<u>(43,710,202)</u>	<u>(40,571,604)</u>
Total Utility Plant	<u>93,501,564</u>	<u>84,924,073</u>
 TOTAL ASSETS	 <u><u>\$ 139,634,028</u></u>	 <u><u>\$ 128,794,918</u></u>

The accompanying notes and independent auditor's report are an integral part of these financial statements.

**CITY OF HUNTSVILLE GAS SYSTEM
STATEMENTS OF NET ASSETS
SEPTEMBER 30, 2010 AND 2009**

LIABILITIES AND NET ASSETS

	<u>2010</u>	<u>2009</u>
Current Liabilities		
Accounts payable - trade	\$ 2,436,952	\$ 1,730,457
Customer meter deposits, including accrued interest of \$2,540,379 in 2010 and \$2,513,058 in 2009	9,104,571	8,791,423
Compensated absences	1,423,202	1,199,807
Customer advances for construction	0	0
Other current liabilities	578,410	543,104
Total Current Liabilities	<u>13,543,135</u>	<u>12,264,791</u>
 Liabilities Payable from Restricted Assets		
Current maturities of revenue bonds	455,000	440,000
Interest payable	60,403	62,786
Total Liabilities Payable from Restricted Assets	<u>515,403</u>	<u>502,786</u>
 Long-Term Debt		
Revenue bonds - less current maturity	<u>8,520,000</u>	<u>8,975,000</u>
 Total Liabilities	<u>22,578,538</u>	<u>21,742,577</u>
 Net Assets		
Invested in capital assets, net of related debt	84,645,457	75,637,670
Restricted	13,211,572	3,028,964
Unrestricted	19,198,461	28,385,707
Total Net Assets	<u>117,055,490</u>	<u>107,052,341</u>
 TOTAL NET ASSETS AND LIABILITIES	<u>\$ 139,634,028</u>	<u>\$ 128,794,918</u>

The accompanying notes and independent auditor's report are an integral part of these financial statements.

**CITY OF HUNTSVILLE GAS SYSTEM
STATEMENTS OF REVENUES, EXPENSES, AND
CHANGES IN NET ASSETS
FOR YEARS ENDED SEPTEMBER 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
Operating Revenue		
Residential	\$ 27,097,128	\$ 26,500,376
Commercial	29,123,133	28,930,139
Industrial	3,407,307	4,114,353
Governmental	0	0
Other operating revenue	3,397,595	3,867,251
Total Operating Revenue	<u>63,025,163</u>	<u>63,412,119</u>
Operating Expenses		
Purchased gas	38,574,435	44,904,955
Production	0	7,828
Distribution	3,861,085	3,968,469
Customer accounting	846,381	711,525
Administrative and general	2,846,699	3,236,865
Depreciation	2,925,642	2,547,783
Payroll taxes	342,402	353,826
Total Operating Expenses	<u>49,396,644</u>	<u>55,731,251</u>
Operating Income	<u>13,628,519</u>	<u>7,680,868</u>
Other Revenue and (Expenses)		
Interest income	158,659	655,143
Loss on sale of fixed assets	0	0
Interest expense	(539,568)	(465,204)
Amortization of debt discount	(12,087)	(12,087)
Total Other Revenue (Expenses)	<u>(392,996)</u>	<u>177,852</u>
Change in Net Assets Before Capital Contributions And Transfers	13,235,523	7,858,720
Capital Contributions	325,499	440,525
Other Non-Operating Income	0	0
Transfers Out - Tax Equivalent	<u>(3,557,873)</u>	<u>(3,572,709)</u>
Change in Net Assets	10,003,149	4,726,536
Beginning Net Assets	<u>107,052,341</u>	<u>102,325,805</u>
Ending Net Assets	<u>\$ 117,055,490</u>	<u>\$ 107,052,341</u>

The accompanying notes and independent auditor's report are an integral part of these financial statements.

**CITY OF HUNTSVILLE GAS SYSTEM
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
CASH FLOWS FROM (USED FOR) OPERATING ACTIVITIES		
Received from customers	\$ 63,443,778	\$ 63,428,851
Paid to suppliers for goods and services	(37,138,603)	(52,792,741)
Paid to employees for goods and services	<u>(5,123,546)</u>	<u>(3,912,779)</u>
Net cash flows from (used for) operating activities	<u>21,181,629</u>	<u>6,723,331</u>
CASH FLOWS FROM (USED FOR) NONCAPITAL FINANCING ACTIVITIES		
Transfers out - tax equivalent	(3,557,873)	(3,572,709)
Proceeds from settlement of lawsuit	0	0
Net cash from (used for) noncapital financing activities	<u>(3,557,873)</u>	<u>(3,572,709)</u>
CASH FLOWS FROM (USED FOR) INVESTING ACTIVITIES		
Interest income earned on investments	<u>158,659</u>	<u>655,143</u>
Net cash from (used for) investing activities	<u>158,659</u>	<u>655,143</u>
CASH FLOWS FROM (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES		
Payment of principal on long-term debt	(440,000)	(425,000)
Additions to plant in service	(11,503,133)	(7,430,692)
Debt expense paid	0	0
Capital contributions	325,499	361,345
Changes in special funds, net	405,513	(616,774)
Interest paid and expensed	<u>(541,951)</u>	<u>(465,204)</u>
Net cash from (used for) capital and related financing activities	<u>(11,754,072)</u>	<u>(8,576,325)</u>
INCREASE (DECREASE) IN CASH	6,028,343	(4,770,560)
CASH AT BEGINNING OF YEAR	<u>14,878,268</u>	<u>19,648,828</u>
CASH AT END OF YEAR	<u>\$ 20,906,611</u>	<u>\$ 14,878,268</u>

The accompanying notes and independent auditor's report are an integral part of these financial statements.

**CITY OF HUNTSVILLE GAS SYSTEM
STATEMENTS OF CASH FLOWS - CONTINUED
FOR THE YEARS ENDED SEPTEMBER 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH FLOWS FROM OPERATING ACTIVITIES		
Operating Income	\$ <u>13,628,519</u>	\$ <u>7,680,868</u>
Adjustments to reconcile operating income to net cash flows from operating activities:		
Depreciation and amortization included in operating	2,925,642	3,105,869
Change in accounts receivable - customer	418,615	16,732
Change in accounts receivable - other	383,293	(990,653)
Change in inventory	2,547,835	(706,894)
Change in prepaid expenses	(619)	151,573
Change in accounts payable	706,495	(3,264,020)
Change in customer deposits	313,148	597,850
Change in accrued expenses and other current liabilities	<u>258,701</u>	<u>132,006</u>
Net Adjustments	<u>7,553,110</u>	<u>(957,537)</u>
NET CASH FLOWS FROM OPERATING ACTIVITIES	<u>\$ 21,181,629</u>	<u>\$ 6,723,331</u>

The accompanying notes and independent auditor's report are an integral part of these financial statements.

**CITY OF HUNTSVILLE WATER SYSTEM
STATEMENTS OF NET ASSETS
SEPTEMBER 30, 2010 AND 2009**

ASSETS

	2010	2009
Current Assets		
Cash and cash equivalents	\$ 14,848,794	\$ 3,276,655
Accounts receivable - trade, net of allowance for doubtful accounts of \$26,324 in 2010 and \$26,324 in 2009	1,202,812	1,745,230
Materials and supplies	1,616,140	1,502,647
Prepaid expenses	1,870	1,818
Total Current Assets	17,669,616	6,526,350
Restricted Assets and Board Designated Assets		
Construction Funds - Designated	5,124,762	4,328,019
Construction Funds - Restricted	6,186,388	11,418,301
Insurance Funds - Designated	1,000,000	555,485
Debt Service Funds - Bond Restricted	5,957,382	5,926,049
Worker's Compensation Funds - Restricted	1,490,903	1,431,190
Renewal and Replacement Funds - Designated	0	1,846,503
Total Restricted Assets and Board Designated Assets	19,759,435	25,505,547
Deferred Charges		
Unamortized bond expense (Note 5)	1,021,387	1,065,635
Other deferred charges	0	0
Total Deferred Charges	1,021,387	1,065,635
Utility Plant (Note 1)		
Plant in service	241,405,262	244,335,430
Construction in progress	8,450,165	2,782,912
	249,855,427	247,118,342
Less: Accumulated depreciation	(88,072,751)	(83,245,133)
Total Utility Plant	161,782,676	163,873,209
TOTAL ASSETS	\$ 200,233,114	\$ 196,970,741

The accompanying notes and independent auditor's report are an integral part of these financial statements.

**CITY OF HUNTSVILLE WATER SYSTEM
STATEMENTS OF NET ASSETS
SEPTEMBER 30, 2010 AND 2009**

LIABILITIES AND NET ASSETS

	<u>2010</u>	<u>2009</u>
Current Liabilities		
Accounts payable - trade	\$ 755,005	\$ 1,551,127
Intercompany payables	0	247,178
Customer meter deposits, including accrued interest of \$1,363,807 in 2010 and \$1,350,052 in 2009	4,565,280	4,408,202
Customer advances for construction	0	0
Compensated absences	1,565,972	1,483,568
Other current liabilities	552,110	1,200,111
Total Current Liabilities	<u>7,438,367</u>	<u>8,890,186</u>
 Liabilities Payable from Restricted Assets		
Current maturities of long-term debt (Note 5)	2,120,000	2,055,000
Interest payable	747,638	775,466
Total Liabilities Payable from Restricted Assets	<u>2,867,638</u>	<u>2,830,466</u>
 Long-Term Debt (Note 5)		
Water revenue bonds, excluding current portion	38,785,000	40,905,000
Unamortized bond premium	1,210,854	1,340,790
Less: Unamortized bond retirement	(250,924)	(311,144)
Total Long-Term Debt	<u>39,744,930</u>	<u>41,934,646</u>
 Total Liabilities	<u>50,050,935</u>	<u>53,655,298</u>
 Net Assets		
Invested in capital assets, net of related debt	120,191,495	120,173,732
Restricted	13,634,674	18,775,540
Unrestricted	16,356,010	4,366,171
Total Net Assets	<u>150,182,179</u>	<u>143,315,443</u>
 TOTAL NET ASSETS AND LIABILITIES	<u>\$ 200,233,114</u>	<u>\$ 196,970,741</u>

The accompanying notes and independent auditor's report are an integral part of these financial statements.

**CITY OF HUNTSVILLE WATER SYSTEM
STATEMENTS OF REVENUE, EXPENSES, AND
CHANGES IN NET ASSETS
FOR YEARS ENDED SEPTEMBER 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
Operating Revenue		
Residential	\$ 12,618,223	\$ 12,554,380
Industrial	1,702,152	1,572,193
Commercial	6,506,573	6,339,244
Government	1,069,288	1,074,255
Fire hydrants	765,554	757,044
Other operating revenue	2,666,237	2,833,618
Total Operating Revenue	<u>25,328,027</u>	<u>25,130,734</u>
 Operating Expenses		
Purification	1,212,275	999,024
Pumping	4,265,256	3,682,596
Distribution	4,047,798	4,237,521
Customer accounting	1,595,675	1,563,388
Administrative and general	4,240,252	4,546,943
Depreciation	5,616,132	4,847,144
Payroll taxes	579,429	536,095
Total Operating Expenses	<u>21,556,817</u>	<u>20,412,711</u>
 Operating Income	<u>3,771,210</u>	<u>4,718,023</u>
 Other Revenue and (Expenses)		
Interest income	70,717	77,629
Interest expense	(1,302,000)	(990,388)
Gain (loss) on sale of assets	1,631,810	0
Amortization of premium on debt	129,936	0
Amortization of bond discount	(44,248)	(44,248)
Total Other Revenue (Expenses)	<u>486,215</u>	<u>(957,007)</u>
 Change in Net Assets before Capital Contributions and Transfers	 4,257,425	 3,761,016
Capital Contributions	3,947,773	4,718,507
Transfers Out - Tax Equivalent	<u>(1,338,462)</u>	<u>(1,357,845)</u>
 Change in Net Assets	 6,866,736	 7,121,678
Beginning Net Assets	<u>143,315,443</u>	<u>136,193,765</u>
Ending Net Assets	<u>\$ 150,182,179</u>	<u>\$ 143,315,443</u>

The accompanying notes and independent auditor's report are an integral part of these financial statements.

**CITY OF HUNTSVILLE WATER SYSTEM
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
CASH FLOWS FROM (USED FOR) OPERATING ACTIVITIES		
Received from customers	\$ 25,870,445	\$ 25,306,156
Paid to suppliers for goods and services	(10,610,521)	(7,892,426)
Paid to employees for goods and services	<u>(6,835,306)</u>	<u>(6,636,891)</u>
Net cash flows from (used for) operating activities	<u>8,424,618</u>	<u>10,776,839</u>
CASH FLOWS FROM (USED FOR) NONCAPITAL FINANCING ACTIVITIES		
Transfers out - tax equivalents	<u>(1,338,462)</u>	<u>(1,357,845)</u>
Net cash flows from (used for) noncapital financing activities	<u>(1,338,462)</u>	<u>(1,357,845)</u>
CASH FLOWS FROM (USED FOR) INVESTING ACTIVITIES		
Deferred charges	0	285,049
Interest income earned on investments	<u>70,717</u>	<u>77,629</u>
Net cash from (used for) investing activities	<u>70,717</u>	<u>362,678</u>
CASH FLOWS FROM (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES		
Payment of principal on long-term debt	(2,055,000)	(639,780)
Proceeds from sale of Triana property	6,750,000	0
Bond issue costs	0	0
Retirement	0	0
Customer advances	0	0
Additions to plant in service	(8,643,791)	(21,464,730)
Capital contributions	3,947,773	4,718,507
Changes in special funds, net	5,746,112	4,971,799
Interest paid	<u>(1,329,828)</u>	<u>(990,388)</u>
Net cash from (used for) capital and related financing activities	<u>4,415,266</u>	<u>(13,404,592)</u>
INCREASE (DECREASE) IN CASH	11,572,139	(3,622,920)
CASH AT BEGINNING OF YEAR	<u>3,276,655</u>	<u>6,899,575</u>
CASH AT END OF YEAR	<u>\$ 14,848,794</u>	<u>\$ 3,276,655</u>

The accompanying notes and independent auditor's report are an integral part of these financial statements.

**CITY OF HUNTSVILLE WATER SYSTEM
STATEMENTS OF CASH FLOWS - CONTINUED
FOR THE YEARS ENDED SEPTEMBER 30, 2010 AND 2009**

	<u>2010</u>	<u>2009</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH FLOWS FROM OPERATING ACTIVITIES		
Operating Income	\$ 3,771,210	\$ 4,718,023
Adjustments to reconcile operating income to net cash flows from operating activities:		
Depreciation and amortization, included in operating	5,676,352	5,251,289
Change in accounts receivable - customer	542,418	175,422
Change in inventory	(113,493)	112,923
Change in prepaid expenses	(52)	209,761
Change in accounts payable	(796,120)	(319,834)
Change in customer deposits	157,078	299,503
Change in accrued expenses and other current liabilities	<u>(812,775)</u>	<u>329,752</u>
Net Adjustments	<u>4,653,408</u>	<u>6,058,816</u>
NET CASH FLOWS FROM OPERATING ACTIVITIES	<u><u>\$ 8,424,618</u></u>	<u><u>\$ 10,776,839</u></u>

The accompanying notes and independent auditor's report are an integral part of these financial statements.

**CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2010 AND 2009**

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Huntsville Utilities (the Utilities) have been prepared in accordance with generally accepted accounting principles (GAAP) of the United States of America as applied to government units. The Governmental Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. The more significant of the Utilities' accounting principles are described below.

Reporting Entity

Statement No. 14 of the GASB establishes standards for defining and reporting on the financial reporting entity. The definition of the reporting entity is based primarily on the notion of financial accountability. A primary government is financially accountable for agencies that make up its legal entity. It is also financially accountable for a legally separate agency if its officials appoint a voting majority of that agency's governing body and either it is able to impose its will on that agency or there is a potential for the agency to provide specific financial benefits to, or to impose specific financial burdens on, the primary government. There are no component units which should be included as part of the financial reporting entity of the Utilities. However, the Utilities are a component unit of the City of Huntsville, Alabama.

Financial Presentation

The Utilities are a component unit of the City of Huntsville and are operated by separate Boards for the electric, natural gas and water systems. The Boards are responsible for the day-to-day operations of the Utilities and for making recommendations to the City for major capital outlays and rate revisions. The Electric Board consists of three members appointed by the Huntsville City Council for staggered three year terms. The Natural Gas and Water Boards are made up of the same three members who serve on each board, simultaneously. The Boards have hired a President and CEO to administer all three utilities. Financial statements are presented for each Board. The footnotes are presented separately for each Board, where applicable, and jointly for areas where common descriptions exist.

Basis of Accounting

The Utilities use the accrual basis of accounting under which revenues are recognized when earned concurrent with billing to customers on a monthly basis and expenses are recognized when incurred, even though actual payment or receipt may not occur until after the period ends.

The Utilities have elected to follow Financial Accounting Standards Board (FASB) pronouncements issued before November 30, 1989 and all pronouncements of the Governmental Accounting Standards Board (GASB) issued after November 30, 1989.

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Basis of Accounting – Continued

Huntsville Utilities has adopted the provisions of GASB Statement 34, “Basic Financial Statements and Management’s Discussion and Analysis for State and Local Governments.” GASB 34 establishes standards for external reporting for all state and local governmental entities and their component units that includes a statement of net assets, a statement of revenues, expenses and changes in net assets, and a statement of cash flows. GASB 34 requires the classification of net assets into three components: 1) invested in capital assets, net of related debt, 2) restricted, and 3) unrestricted. These classifications are defined as follows:

- 1) Invested in capital assets, net of related debt – This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the capital assets.
- 2) Restricted – This component of net assets consists of constraints placed on net asset use through external constraints imposed by creditors, such as debt covenants, grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional or enabling legislation.
- 3) Unrestricted – This component of net assets consists of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

Huntsville Utilities has also adopted the provisions of Governmental Accounting Standards Board Statement 33, Accounting for Financial Reporting for Non-exchange transactions. This statement requires that capital contributions – aid to construction – to the Utilities be presented as a change in net assets.

Board Designated Cash and Board Designated Unrestricted Net Assets

The Boards have designated that cash assets be set aside in each System to fund construction and renewal and replacement activity. The designations are segregated in the statements of net assets as special funds. Designations are relieved once the Board has approved expenditures from those funds. The designated balances are fully funded and are not separately stated in the net assets portion of the statements of net assets at September 30, 2010 and 2009.

Grants in Aid of Construction

It is the Electric System's policy not to record amounts as grants in aid of construction. The authoritative support for this is Federal Power Commission order number 490. The substance of this accounting treatment is to reduce the cost of operating the Electric System by reducing depreciation expense.

It is the Water and Natural Gas System's policy to record grants in aid of construction and other amounts received as capital contributions in the statement of revenues, expenses and changes in net assets.

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Utility Plant

Utility plant and construction in progress are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful life of the assets ranging from five to fifty years. Retirements of units of property from service are credited against plant in service at the original cost of the units and accumulated depreciation is debited at the date of retirement. Improvements that extend the useful life of the assets are capitalized and depreciated over the remaining useful life of the asset. The cost of maintenance, repairs and replacement of minor items of property are charged to operations and maintenance accounts. Interest on bonds is capitalized during the construction period for assets financed by bond proceeds.

Revenue and Concentration of Credit Risk

Huntsville Utilities accrues receivables for the most recent meter reading at the end of the year. Huntsville Utilities' customers are located in the City of Huntsville and Madison County Alabama.

Accounts Receivable - Trade

The Electric System acts as a billing and collection agent for other City of Huntsville and Madison County utility departments. Current earnings are charged with an allowance for doubtful accounts based on a percent of gross revenue, determined from prior years' bad debt experience. Receivables are due 15 days after the issuance of the invoice and are considered delinquent when more than 25 days past due. Accounts considered uncollectible throughout the year are charged against the allowance.

Materials and Supplies Inventories

Materials and supplies inventories are stated at the lower of cost (average cost) or market.

Stored Gas Inventory

Under the Federal Energy Regulatory Commission Order 636, Huntsville Utilities' natural gas and propane supply and storage from its vendor are unbundled. The result led to an election by the utility to store gas rather than be penalized for no notice service. The stored inventory is reflected at the aggregate amount of the lower of cost (average cost) or market.

Accounts Receivable/Payable from/to Other Utilities

Included in other receivables are amounts due from the other utility systems for services rendered to them by the Electric System. Included in the payable is cash held by the Electric System in the master account for the benefit of other City of Huntsville and Madison County utility departments and amounts owed to the other departments for services rendered by them to the Electric System.

Customer Deposits

Customer deposits are reflected in the financial statements as current liabilities in accordance with guidelines established by the Federal Energy Power Commission (FERC). Local ordinance permits Huntsville Utilities to accrue and pay to customers interest earned on their deposits.

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Cash and Cash Equivalents

For purposes of the statements of cash flows, the Utilities consider all highly liquid temporary cash investments with low interest rate risk to be cash equivalents. Cash purchases and sales of these investments generally are part of the entity's cash management activities rather than part of its operating, investing and financing activities, and details of these transactions are not reported in the statements of cash flows. Special funds are provided for under trust indentures and are not considered cash equivalents. All special funds are considered investments for purposes of classification in the statement of cash flows.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Accordingly, actual results could differ from those estimates.

NOTE 2 - TAX EQUIVALENTS

Since the Utilities are owned by the City of Huntsville, they are not subject to income taxes, either at the federal or state level. The Electric System, however, does pay to the City of Huntsville a tax equivalent which is determined by applying the current property tax rates to net plant in service at the end of the preceding year.

The Natural Gas and Water Systems each pay a tax equivalent which is a predetermined (6%) percentage of sales revenue. The tax equivalent for the years ended September 30, 2010 and 2009 are as follows:

	2010	2009
Electric System	\$ 11,763,798	\$ 10,595,126
Natural Gas System	3,557,873	3,572,709
Water System	1,338,462	1,357,845

NOTE 3 – EMPLOYEE BENEFITS

The annual leave policy allows each employee to accumulate up to thirty-five days of annual leave. The Utilities follow the practice of accruing the dollar amount of the leave accrued per each employee on a monthly basis. Actual leave time taken is charged against this account. The sick leave policy provides that at the time of retirement, each employee will be paid 25% of the accumulated sick leave based on the employee's average salary during the last five years. The Utilities follow the practice of accruing 25% of accumulated sick leave based on average salaries for the past five years for employees who have attained a specified period of service or age. Accrued annual leave and sick leave at September 30, 2010 and 2009 are as follows:

NOTES TO FINANCIAL STATEMENTS - CONTINUED

NOTE 3 – EMPLOYEE BENEFITS - CONTINUED

	Accrued Annual Leave		Accrued Sick Leave	
	2010	2009	2010	2009
Electric System	\$ 2,126,406	\$ 1,952,891	\$ 1,519,190	\$ 1,406,868
Natural Gas System	766,910	659,029	656,292	540,778
Water System	852,525	795,294	713,447	688,274

NOTE 4 - DEFINED BENEFIT PENSION PLAN AND DESCRIPTION

Substantially all employees of the City of Huntsville Electric, Natural Gas and Water Systems (the "Utilities") are members of the Employees' Retirement System of Alabama (RSA). Membership is mandatory for covered or eligible employees. The pension plan provides pension benefits, deferred allowances, death and disability benefits and surviving spouse benefits. A member may retire after reaching the age of 60 or accumulating 30 years of service with the Utilities. Benefits vest after 10 years of service. The Utilities are affiliated with RSA, an agent multiple-employer pension plan. RSA issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to the RSA. Benefit provisions are established and amended by State statute.

The employee retirement system was established as of October 1, 1945, and placed under the management of the board of control (currently 10 members) by Act 515, Acts of Alabama 1945. Employees of the Utilities are required to pay 5% of their gross earnings to the pension plan. The Utilities are required to contribute the remaining amounts necessary to fund the plan, using the actuarial method, "entry age normal."

During 2010 and 2009, the Utilities were required to contribute the following percentages of gross payroll to the plan:

	<u>2010</u>	<u>2009</u>
Electric System	17.71%	17.71%
Natural Gas System	11.16%	11.16%
Water System	12.87%	12.87%

Based on an actuarial valuation completed as of September 30, 2009, the Annual Pension Cost for the System is as follows:

	Annual Pension Cost (APC) 2009	Annual Pension Cost (APC) 2008	Percentage of APC Contributed 2009 and 2008
Electric System	\$1,775,412	\$1,474,244	101.9%
Natural Gas System	1,973,248	1,685,679	102%
Water System	634,013	521,569	102%

NOTES TO THE FINANCIAL STATEMENTS – CONTINUED

NOTE 4 - DEFINED BENEFIT PENSION PLAN AND DESCRIPTION - CONTINUED

The natural gas system APC includes joint employees carried on the gas system payroll. Actual expenses are prorated by number of employees per system.

The Huntsville Utilities' Funding Progress in the schedules below is equal to the Utilities' required and actual contributions. The required contribution was determined as part of the September 30, 2009 actuarial valuation using the entry age actuarial cost method. The actuarial assumptions included (a) an 8% investment rate of return (net of administrative expenses), (b) projected salary increases of between 4.61% and 7.75% a year, (c) 0% per year cost of living adjustments. Both (a) and (b) included an inflation component of 4.5%. The actuarial value of the System's assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a five-year period. The system's unfunded actuarial liability is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at September 30, 2009 was 23 years for the Gas System, 25 years for the Water System and 21 years for the Electric System.

Based on an actuarial valuation done in September 30, 2009, the most recent year for which information is available the schedule of Funding Progress for the System is as follows:

Electric

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liab. (AAL)	Funding Under/(Over) AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL Percentage of Payroll
2005	\$28,094,541	\$42,619,069	\$14,524,528	65.9%	\$9,080,096	160.0%
2006	\$28,828,749	\$46,128,654	\$17,299,905	62.5%	\$9,238,666	187.3%
2007	\$29,963,494	\$47,730,823	\$17,767,329	62.8%	\$9,572,827	185.6%
2008	\$29,933,875	\$50,264,649	\$20,330,774	59.6%	\$10,087,229	201.5%
2009	\$29,667,953	\$52,088,628	\$22,420,675	57.0%	\$10,705,886	209.4%

Water

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liab. (AAL)	Funding Under/(Over) AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL Percentage of Payroll
2005	\$14,284,170	\$18,502,405	\$4,218,235	77.2%	\$4,600,552	91.7%
2006	\$14,848,340	\$20,040,427	\$5,192,088	74.1%	\$4,709,711	110.2%
2007	\$15,633,561	\$21,323,229	\$5,689,669	73.3%	\$5,033,225	113.0%
2008	\$15,922,622	\$23,140,702	\$7,218,080	68.8%	\$5,460,826	132.2%
2009	\$15,822,183	\$24,304,373	\$8,482,190	65.1%	\$5,579,512	152.0%

Gas

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liab. (AAL)	Funding Under/(Over) AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL Percentage of Payroll
2005	\$34,905,665	\$47,605,902	\$12,700,237	73.3%	\$13,842,546	91.7%
2006	\$36,313,068	\$51,562,348	\$15,249,280	70.4%	\$14,631,348	104.2%
2007	\$38,523,025	\$54,570,361	\$16,047,336	70.6%	\$15,942,981	100.7%
2008	\$39,258,315	\$58,009,060	\$18,750,745	67.7%	\$17,196,989	109.0%
2009	\$39,481,623	\$61,824,224	\$22,342,601	63.9%	\$18,404,081	121.4%

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

NOTE 5 - LONG-TERM DEBT

Electric System Revenue Refunding Warrants, Series 2001

Electric System Revenue Warrants, Series 2001, were issued in the original amount of \$6,070,000. The warrants mature serially on December 1 each year and bear interest according to stated maturity dates:

Fiscal Year	2001 Principal	2001 Interest	2001 Rate
2011	\$ 465,000	\$ 107,520	4.200%
2012	490,000	87,343	4.250%
2013	510,000	65,965	4.300%
2014	535,000	41,625	5.000%
2015	565,000	14,125	5.000%
	2,565,000		
Current	465,000		
	\$ 2,100,000		

The 2001 issue contained deferred cost of \$75,861 that is being amortized over 13 years. At September 30, 2010, the unamortized deferred cost is \$23,882.

The Electric System is required to establish a cash reserve fund equal to the maximum annual debt service requirement. At September 30, 2010, the balance in the fund is the minimum required by the indenture. The bond indenture requires the Electric System to establish a cash reserve account equal to one-twelfth (1/12) of the principal of the Series 2001 warrants coming due on December 1 each year and one-sixth (1/6) of the interest due each year. At September 30, 2010, the balance in the funds is in compliance with the indenture. The Electric System Revenue Warrants, Series 2001 are in compliance with Internal Revenue Code Sections 103(b)(2) and 148.

The 2001 warrants are secured by the net revenues from the operations of the Electric System after payment of the cost of its operations and maintenance and by the monies and investments on deposit in trust funds created by the Trust Indenture under which the warrants were issued.

The 2001 Series Warrants maturing in 2008 will be subject to redemption at the option of the City of Huntsville, Alabama, on December 1, 2008, and on any date thereafter, plus accrued interest as follows:

Redemption Dates	Redemption Price
December 1, 2008, through November 30, 2009	102%
December 1, 2009, through November 30, 2010	101%
December 1, 2010, and thereafter	100%

City of Huntsville, Alabama Electric System Revenue Warrants, Series 1998

Electric System Revenue Warrants, Series 1998, were issued in the original principal amount of \$15,505,000. The warrants were retired on December 1, 2010.

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

NOTE 5 - LONG-TERM DEBT - CONTINUED

City of Huntsville, Alabama Electric System Revenue and Term Warrants, Series 2002

Electric System Revenue Warrants, Series 2002, were issued in the original amount of \$8,525,000. Electric System Term Warrants, Series 2002, were issued in the original amount of \$1,395,000. The warrants mature serially on December 1 each year and bear interest according to stated maturity dates as follows:

Fiscal Year		2002 Principal		2002 Interest		2002 Rate
2011	\$	285,000	\$	219,600		3.65%
2012		295,000		209,247		3.90%
2013		310,000		197,743		4.00%
2014		320,000		185,342		4.15%
2015		335,000		172,063		4.25%
2016		350,000		157,825		4.40%
2017		365,000		142,425		4.50%
2018		385,000		126,000		4.60%
2019		400,000		108,290		4.70%
2020		420,000		89,490		4.70%
2021*		440,000		69,750		5.00% *
2022*		465,000		47,750		5.00% *
2023*		490,000		24,500		5.00% *
		<u>4,860,000</u>				
Current		285,000				
	\$	<u>4,575,000</u>				

* - Term Warrants

2002 Series Serial Warrants maturing in 2012 will be subject to redemption at the option of the City of Huntsville, Alabama, on December 1, 2012, and on any date thereafter, plus accrued interest as follows:

<u>Redemption Dates</u>	<u>Redemption Price</u>
December 1, 2012, through November 30, 2013	101%
December 1, 2013 and thereafter	100%

2002 Series Term Warrants maturing in 2022 will be subject to mandatory redemption by the City of Huntsville, Alabama. The principal required to be redeemed plus accrued interest is as follows:

<u>Redemption Dates</u>	<u>Redemption Price</u>
December 1, 2020	\$440,000
December 1, 2021	465,000
December 1, 2022	490,000

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

NOTE 5 - LONG-TERM DEBT -- CONTINUED

City of Huntsville, Alabama Electric System Revenue and Term Warrants, Series 2002 - Continued

The Electric System is required to establish a cash reserve fund equal to the maximum annual debt service requirement. At September 30, 2010, the balance in the fund is the minimum required by the indenture. The bond indenture requires the Electric System to establish a cash reserve account equal to one-twelfth (1/12) of the principal of the Series 2002 Warrants coming due on December 1 each year and one-sixth (1/6) of the interest due each year. At September 30, 2010, the balance in the fund is in compliance with the indenture. The Electric System Revenue Warrants, Series 2002 is in compliance with Internal Revenue Code Sections 103(b)(2) and 148.

The 2002 Warrants are secured by the net revenues from the operations of the Electric System after payment of the cost of its operations and maintenance and by the monies and investments on deposit in trust funds created by the Trust Indenture under which the warrants were issued.

The 2002 issue contained deferred cost of \$171,056 that is being amortized over 20 years. At September 30, 2010, the unamortized deferred cost is \$105,485.

The Series 2002 Revenue Warrants were issued to redeem the Series 1993 Warrants and to pay costs of capital improvements to the Electric System.

City of Huntsville, Alabama Electric System Revenue Warrants, Series 2007

Electric System Revenue Warrants, Series 2007, were issued in the original amount of \$13,195,000. The warrants mature serially on December 1 each year and bear interest according to stated maturity dates as follows:

Fiscal Year	2007 Principal	2007 Interest	2007 Rate
2011	705,000	513,700	4.00%
2012	1,070,000	478,200	4.00%
2013	1,110,000	434,600	4.00%
2014	1,155,000	389,300	4.00%
2015	1,205,000	342,100	4.00%
2016	1,865,000	280,700	4.00%
2017	1,945,000	204,500	4.00%
2018	2,030,000	125,000	4.00%
2019	2,110,000	42,200	4.00%
	13,195,000		
Current	705,000		
	\$ 12,490,000		

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

NOTE 5 - LONG-TERM DEBT – CONTINUED

City of Huntsville, Alabama Electric System Revenue Warrants, Series 2007 - Continued

The 2007 issue contained deferred cost of \$668,300 that is being amortized over 10 years. At September 30, 2010, the unamortized deferred cost is \$515,479. The 2007 issue also contained a premium of \$264,012 that is being amortized over 10 years. At September 30, 2010, the unamortized premium is \$191,019.

The 2007 Series Warrants maturing in 2018 shall be subject to redemption prior to their respective maturities, at the option of the City, on December 1, 2017, and on any date thereafter, as a whole or in part, at the redemption price equal to the principal amount thereof to be redeemed plus accrued interest to the redemption date.

The 2007 Warrants are secured by the net revenues from the operations of the Electric System after payment of the cost of its operations and maintenance and by the monies and investments on deposit in trust funds created by the Trust Indenture under which the warrants were issued

The Electric System is required to establish a cash reserve fund equal to the maximum annual debt service requirement. At September 30, 2010, the balance in the fund is the minimum required by the indenture. The bond indenture requires the Electric System to establish a cash reserve account equal to one-twelfth (1/12) of the principal of the Series 2007 Warrants coming due on December 1 each year and one-sixth (1/6) of the interest due each year. At September 30, 2010, the balance in the fund is in compliance with the indenture. The Electric System Revenue Warrants, Series 2007 is in compliance with Internal Revenue Code Sections 103(b)(2) and 148.

The Series 2007 Revenue Warrants were issued to redeem a large portion of the Series 1998 Warrants and to pay costs of capital improvements to the Electric System.

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

NOTE 5 - LONG-TERM DEBT – CONTINUED

City of Huntsville, Alabama Natural Gas System Revenue Warrants, Series 2005

Natural Gas System Revenue Warrants, Series 2005, were issued in the original amount of \$11,025,000. The warrants mature serially on August 1 each year and bear interest according to stated maturity dates as follows:

Fiscal Year	2005 Principal Maturity	2005 Interest Maturity	2005 Rate
2011	\$ 455,000	\$ 362,419	3.50%
2012	470,000	346,494	3.50%
2013	485,000	330,044	3.60%
2014	505,000	312,584	3.80%
2015	520,000	293,394	3.88%
2016	545,000	273,244	4.00%
2017	565,000	251,444	4.00%
2018	585,000	228,844	4.00%
2019	610,000	205,444	4.13%
2020	635,000	180,281	4.13%
2021	660,000	154,088	4.13%
2022	690,000	126,863	4.25%
2023	720,000	97,537	4.25%
2024	750,000	66,938	4.38%
2025	780,000	34,125	4.38%
	<u>8,975,000</u>		
Current	455,000		
	<u>\$ 8,520,000</u>		

The Natural Gas System is required to establish a cash reserve fund equal to the maximum annual debt service requirement. At September 30, 2010, the balance in the fund is the minimum required by the indenture. The bond indenture requires the Natural Gas System to establish a cash reserve account equal to one-twelfth (1/12) of the principal of the Series 2005 Warrants coming due on August 1 each year and one-sixth (1/6) of the interest due each August 1 and February 1 each year. At September 30, 2010, the balance in the funds is in compliance with the indenture. The Natural Gas Revenue Warrants, Series 2005 is in compliance with Internal Revenue Code Sections 103(b)(2) and 148.

The 2005 Warrants are secured by the net revenues from the operations of the Natural Gas System after payment of the cost of its operations and maintenance and by the monies and investments on deposit in trust funds created by the Trust Indenture under which the warrants were issued.

The 2005 issue contained deferred cost of \$241,756 that is being amortized over 20 years. At September 30, 2010, the unamortized deferred cost is \$179,296.

The Natural Gas System, Series 2005 Warrants will be subject to redemption prior to their respective maturities, at the option of the City, as a whole or in part on August 1, 2015, and on any date thereafter, at a redemption price equal to the par amount thereof, plus accrued interest to the date fixed for the redemption.

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

NOTE 5 - LONG-TERM DEBT – CONTINUED

City of Huntsville, Alabama Water Revenue and Term Warrants, Series 2008

Water System Revenue Warrants, Series 2008, were issued in the original amount of \$43,660,000. The warrants mature serially on November 1 each year and bear interest according to stated maturity dates as follows:

Fiscal Year	2008 Principal	2008 Interest	2008 Rate	
2011	\$ 2,120,000	\$ 1,759,880	3.25%	
2012	2,190,000	1,695,865	2.70%	
2013	2,260,000	1,632,965	2.95%	
2014	2,330,000	1,563,515	3.10%	
2015	2,400,000	1,488,400	3.25%	
2016	2,490,000	1,387,150	5.00%	
2017	2,615,000	1,259,525	5.00%	
2018	2,750,000	1,125,400	5.00%	
2019	2,885,000	984,525	5.00%	*
2020	880,000	890,400	5.00%	*
2021	925,000	845,275	5.00%	*
2022	970,000	797,900	5.00%	*
2023	1,020,000	748,150	5.00%	*
2024	1,075,000	695,775	5.00%	*
2025	1,125,000	643,588	5.00%	*
2026	1,175,000	591,838	5.00%	*
2027	1,230,000	537,725	5.00%	*
2028	1,290,000	481,025	5.00%	*
2029	1,350,000	421,625	4.50%	*
2030	1,415,000	355,875	4.50%	*
2031	1,485,000	283,375	4.50%	*
2032	1,560,000	207,250	4.50%	*
2033	1,640,000	127,250	4.50%	*
2034	1,725,000	43,125	5.00%	*
	<u>40,905,000</u>			
Current	2,120,000			
	<u>\$ 38,785,000</u>			

* - Term Warrants

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

NOTE 5 - LONG-TERM DEBT – CONTINUED

City of Huntsville, Alabama Water Revenue and Term Warrants, Series 2008 – Continued

The Series 2008 Warrants maturing on November 1, 2018 and thereafter are subject to redemption at the option of the City on any date on or after May 1, 2018 in whole, or in part in \$5,000 multiples in such order and amount of maturities as the City shall determine in its sole discretion, at a redemption price for each Series 2008 Warrant (or principal portion thereof) to be redeemed of par, plus accrued interest thereon to the date fixed for redemption, without premium or penalty.

The Series 2008 Warrants with a stated maturity on November 1, 2023 are required to be redeemed on November 1 in the following years in the following principal amounts at a redemption price equal to the principal amount thereof to be redeemed plus accrued interest thereon, without premium or penalty:

<u>Redemption Dates</u>	<u>Redemption Price</u>
2019	\$880,000
2020	925,000
2021	970,000
2022	1,020,000

The remainder of the 2023 Term Warrants in principal amount of \$1,075,000 will mature on November 1, 2023.

The Series 2008 Warrants with a stated maturity on November 1, 2028 are required to be redeemed on November 1 in the following years in the following principal amounts at a redemption price equal to the principal amount thereof to be redeemed plus accrued interest thereon, without premium or penalty:

<u>Redemption Dates</u>	<u>Redemption Price</u>
2024	\$1,125,000
2025	1,175,000
2026	1,230,000
2027	1,290,000

The remainder of the 2028 Term Warrants in principal amount of \$1,350,000 will mature on November 1, 2028.

The Series 2008 Warrants with a stated maturity on November 1, 2033 are required to be redeemed on November 1 in the following years in the following principal amounts at a redemption price equal to the principal amount thereof to be redeemed plus accrued interest thereon, without premium or penalty:

<u>Redemption Dates</u>	<u>Redemption Price</u>
2029	\$1,415,000
2030	1,485,000
2031	1,560,000
2032	1,640,000

The remainder of the 2033 Term Warrants in principal amount of \$1,725,000 will mature on November 1, 2033.

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

NOTE 5 - LONG-TERM DEBT - CONTINUED

City of Huntsville, Alabama Water Revenue and Term Warrants, Series 2008 – Continued

The Water System is required to establish a cash reserve fund equal to the maximum annual debt service requirement. At September 30, 2010, the balance in the fund is the minimum required by the indenture. The bond indenture requires the Water System to establish a cash reserve account equal to one-twelfth (1/12) of the principal of the Series 2008 Warrants coming due on November 1 each year and one-sixth (1/6) of the interest due each year. At September 30, 2010, the balance in the fund is in compliance with the indenture. The Water System Revenue Warrants, Series 2008 is in compliance with Internal Revenue Code Sections 103(b)(2) and 148.

The 2008 Warrants are secured by the net revenues from the operations of the Water System after payment of the cost of its operations and maintenance and by the monies and investments on deposit in trust funds created by the Trust Indenture under which the warrants were issued.

The 2008 issue contained deferred cost of \$1,120,915 that is being amortized over 25 years. At September 30, 2010, the unamortized deferred cost is \$1,021,387. The 2008 issue also contained a premium of \$1,340,790 that is being amortized over 25 years. At September 30, 2010, the unamortized premium is \$1,210,854.

The Series 2008 Revenue Warrants were issued to redeem the Series 1998 Warrants and to pay costs of capital improvements to the Water System.

At September 30, 2010, the Water System also recognizes deferred costs related to prior year bond retirements in the amount of \$250,924, including related amortization expenses of \$60,220.

Long-Term Debt by System

Principal activity for the year is summarized as follows:

	<u>Beginning</u>	<u>Additions</u>	<u>Retirements</u>	<u>Ending</u>
Electric	\$ 22,235,000	\$ 0	\$ 1,615,000	\$ 20,620,000
Gas	9,415,000	0	440,000	8,975,000
Water	42,960,000	0	2,055,000	40,905,000
Total	<u>\$ 74,610,000</u>	<u>\$ 0</u>	<u>\$ 4,110,000</u>	<u>\$ 70,500,000</u>

NOTE 6 - DEPOSITS WITH FINANCIAL INSTITUTIONS

At September 30, 2010, all cash and cash equivalents of the Utilities are entirely insured or collateralized as provided by the Security for Alabama Funds Enhancement Act (SAFE) as prescribed in section 41-14A of the code of the state of Alabama with a Qualified Public Fund Depository. Funds held by the banks' trust departments or agents are invested in U. S. governmental securities or are secured by U. S. government securities.

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

NOTE 6 - DEPOSITS WITH FINANCIAL INSTITUTIONS – CONTINUED

A summary of cash and investments is as follows:

<u>Description</u>	<u>Electric System</u>	<u>Natural Gas System</u>	<u>Water System</u>
Cash on hand	\$ 11,450	\$ 0	\$ 0
Carrying amounts of:			
Deposits	73,941,192	36,257,200	22,464,459
Investments	4,279,146	954,513	12,143,770
Total	<u>\$ 78,231,786</u>	<u>\$ 37,211,713</u>	<u>\$ 34,608,229</u>
Deposits - Cash	\$ 51,951,785	\$ 20,906,611	\$ 14,848,794
Investments:			
Debt service accounts	4,279,146	954,513	5,957,382
Bond construction funds	500,000	0	6,186,388
Other third party restricted	2,139,489	2,139,017	1,490,903
Board designated accounts:			
Renewal and replacement	3,109,364	2,754,489	0
Construction	11,726,914	6,959,413	3,588,787
Emergency	3,000,000	0	0
Insurance	1,253,398	997,670	1,000,000
Rate Stabilization	0	2,500,000	0
Other	271,691	0	1,535,975
Total	<u>\$ 78,231,787</u>	<u>\$ 37,211,713</u>	<u>\$ 34,608,229</u>

At September 30, 2010, the Utilities had the following investments held by a trustee.

<u>Investment</u>	<u>Fair Value</u>	<u>Maturity</u>
Repurchase agreement	\$ 2,705,428	11/30/22
U.S. Treasury Securities Funds	\$14,672,000	Average maturity of the fund's securities 397 days or less
	<u>\$17,377,428</u>	

Interest rate risk - In accordance with its bond indenture, the Utilities manage its exposure to declines in fair values by limiting the weighted average maturity of its investment portfolio in the bond funds to such stated maturities as will assure the availability of cash sufficient to pay, on a timely basis, the interest and principal of the bonds coming due.

Credit risk - The Utilities' bond indentures for the outstanding Electric System Revenue Warrants, the Natural Gas Revenue Warrants, and the Water System Revenue Warrants, limit the investments of the various funds to the following: (a) securities that are direct obligations of the United States and any securities that are with respect to which the payment of the principal thereof and the interest thereon is unconditionally and irrevocably guaranteed by the United States; (b) custodial receipts evidencing ownership in United States Treasury obligations; and (c) demand or time deposits in domestic banks rated no less than "AA" by Standard & Poor's Ratings Services or "Aa" by Moody's Investors Service.

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

NOTE 6 - DEPOSITS WITH FINANCIAL INSTITUTIONS – CONTINUED

At September 30, 2010, the Utilities' investments consisted of RMK Select Treasury Money Market Funds and JP Morgan 100% U.S. Treasury Securities Money Market Funds which are primarily comprised of U.S. Treasury obligations maturing in 397 days or less. In addition, the Utilities have invested in a repurchase agreement which is collateralized by U.S. Treasury obligations.

Custodial Credit risk - For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Utilities will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. Of the Utilities' investments in the repurchase agreement, underlying securities having a fair value of approximately \$5 million at September 30, 2010 are held by the investment's counterparty, not in the name of the Utility.

NOTE 7 - PROPERTY AND RIGHTS HELD UNDER DEFERRED COMPENSATION PLAN

Employees of the Utilities may participate in a deferred compensation plan adopted under the provisions of Internal Revenue Code Section 457 (Deferred Compensation Plans with Respect to Service for State and Local Governments). The deferred compensation plan is administered by an unrelated financial institution. Under the terms of an IRC Section 457 deferred compensation plan, all deferred compensation and income attributable to the investment of the deferred compensation amounts held by the financial institution, until paid or made available to the employees or beneficiaries, are the property of the Utilities subject only to the claims of the Utilities general creditors. In addition, the participants in the plan have rights equal to those of the general creditors of the Utilities, and each participant's rights are equal to his or her share of their fair market value of the plan assets. The Utilities believe that it is unlikely that plan assets will be needed to satisfy claims of general creditors that might arise. These assets and related liabilities are not reflected on the books and records of the City of Huntsville Utility Departments.

NOTE 8 - CONTINGENCIES

The Utilities are a party to a number of other legal actions arising in the ordinary course of its business. In management's opinion, the Utilities' have adequate legal defenses and / or insurance coverage respecting each of these actions and does not believe that they will materially affect the Utilities' operations or financial position.

NOTE 9 – GAS PURCHASE COMMITMENTS

The Gas System has entered into a purchase contract with Tennessee Energy Acquisition Corporation to establish the purchase price for natural gas. The contracts allow the Gas System to lock in certain volumes of gas to be purchased and prices for that gas. Under the contract, the Gas System has committed to purchase between 537,000 and 1,582,000 MMBtus per year through December 2026 at index less fifty-six cents.

NOTE 10 – ELECTRIC PURCHASE COMMITMENTS

Under its wholesale power agreement, the Electric System is committed to purchase its electric power and energy requirement from the Tennessee Valley Authority. The rates for such purchases are subject to review periodically.

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

NOTE 11 – INSURANCE IN FORCE

Insurance coverage is combined for the Electric, Water and Gas Utilities with the expense prorated to each department on a predetermined percentage:

Blanket Real and Personal Property			
Real property	\$		304,787,250
Flood and earthquake			10,000,000
Blanket Crime			1,000,000
Automobile Liability			1,000,000
Public Officials and Employment Liability			1,000,000
Workers Compensation			
Bodily injury (accident and disease)		Statutory	
Excess coverage per occurrence (SIR)		500,000	
Comprehensive General Liability		Self-insured	

The Utilities are self-insured for general liability, health insurance and worker’s compensation. Reinsurance is purchased to limit the exposure to catastrophic loss for health and worker’s compensation. The health insurance program is administered by Blue Cross/Blue Shield of Alabama. The general liability self-insurance program is administered internally. Amtrust North America administers worker’s compensation claims. The Boards have designated that cash assets be set aside in each system to fund these activities. The balances have been fully funded in segregated accounts in the special funds section of the statements of net assets and except for workers compensation are not separately stated in the net assets portion of the statements of net assets. Worker’s compensation funds are included in restricted net assets, as listed below:

		2010		2009
Electric	\$	2,139,489	\$	1,978,709
Gas		2,139,017		2,074,543
Water		1,490,903		1,431,190
	\$	5,769,409	\$	5,484,442

NOTE 12 - POST-EMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS

In addition to the Annual Leave and Sick Leave benefits described in Note 3 and the Pension benefits described in Note 4, the Utilities provide post-retirement Medical and nominal Life Insurance to all employees who retire from the Utilities under the provisions of the qualified plan and a minimum of 20 years of service. As of October 1, 2009, approximately 227 retirees meet those eligibility requirements. Expenses for these post-retirement benefits have previously been recognized as retirees report claims. During the year ended September 30, 2008 the Utilities implemented the provisions of GASB Statement No. 45 titled “Accounting and Financial Reporting by Employers for Post-Employment Benefits Other Than Pensions”. These provisions were applied prospectively with respect to the Utilities’ Other Post-Employment Benefits (OPEB) Plan. GASB Statement No. 45 requires the accrual of OPEB obligations over the working career of plan members rather than as claims are incurred. The total expense that was recognized under these new requirements during the years ended September 30, 2010 and 2009 totaled \$2,007,975 and \$2,783,398, respectively.

NOTES TO THE FINANCIAL STATEMENTS – CONTINUED

NOTE 12 - POST-EMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS - CONTINUED

The Utilities' annual OPEB cost (expense) is calculated based on the annual required contribution (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. Amounts determined regarding the funded status of the plan and the ARC of the Utilities are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events in the future.

The ARC represents 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 thirty-year period beginning October 1, 2007 with a 7% discount rate. The ARC for the Utilities is \$2,007,975. The present value of the OPEB is \$37,700,707 with an actuarial accrued liability of \$29,677,256. While the Utilities established an irrevocable trust to pay its OPEB, full funding was not made until October of 2008. Future funding will be made in the fiscal year affected. The market value of the assets, then, was \$3,039,585 as of 10/1/09. Health care costs were trended at an initial rate of 10% with an ultimate rate of 4.5%. The ultimate rate trends to be reached in 2026.

NOTE 13 – TVA CONTRACT PAYABLE AND PRIOR YEAR ADJUSTMENT

The Electric System has been notified of Unbilled contract payments by TVA for the years 2004 to 2010. The adjustments increase the cost of power for each of the years. An adjustment to Beginning Net Assets of \$22,220,859 was made restating the previous balance. Power costs were increased by \$6,022,618 for the year ending 2009, which reduced net income for the year by the same amount. The balance of the outstanding Unbilled contract payables was \$35,272,375 at September 30, 2010.

NOTE 14 – SUBSEQUENT EVENTS

The Electric System Revenue Refunding Warrants, Series 2001 were paid off on January 3, 2011. The remaining \$2,100,000 was paid off at that time.

The date through which subsequent events have been evaluated is March 28, 2011. The financial statements were available to be issued at that time.

NOTE 14 - UTILITY PLANT IN SERVICE

ELECTRIC SYSTEM

	Balance October 1, 2008	Additions	Retirements	Balance September, 30 2009
Land and land rights	\$ 4,288,600	\$ 21,000	\$ -	\$ 4,309,600
Structures and improvements	348,033,974	29,067,214	(1,480,565)	375,620,623
Furniture, fixtures and other	<u>18,575,018</u>	<u>11,494,537</u>	<u>(1,814,069)</u>	<u>28,255,486</u>
Total	370,897,592	40,582,751	(3,294,634)	408,185,709
Less accumulated depreciation	(160,614,128)	(13,579,089)	3,474,811	(170,718,406)
Retirement in progress	3,891	-	(3,891)	0
Construction in progress	<u>14,759,234</u>	31,920,725	(42,452,067)	<u>4,227,892</u>
	<u>\$ 225,046,589</u>			<u>\$ 241,695,195</u>

	Balance October 1, 2009	Additions	Retirements	Balance September, 30 2010
Land and land rights	\$ 4,309,600	\$ 110,873	\$ -	\$ 4,420,473
Structures and improvements	375,620,623	14,326,399	(1,362,406)	388,584,616
Furniture, fixtures and other	<u>28,255,486</u>	<u>2,196,912</u>	<u>(64,639)</u>	<u>30,387,759</u>
Total	408,185,709	16,634,184	(1,427,045)	423,392,848
Less accumulated depreciation	(170,718,406)	(15,440,976)	826,789	(185,332,593)
Retirement in progress	0	-	-	0
Construction in progress	<u>4,227,892</u>	12,990,301	(7,242,847)	<u>9,975,346</u>
	<u>\$ 241,695,195</u>			<u>\$ 248,035,601</u>

NOTE 14 - UTILITY PLANT IN SERVICE - CONTINUED

NATURAL GAS SYSTEM

	Balance October 1, 2008	Additions	Retirements	Balance September, 30 2009
Land and land rights	\$ 471,235	\$ -	\$ -	\$ 471,235
Structures and improvements	109,088,656	6,431,833	(304,578)	115,215,911
Furniture, equipment and other	<u>7,458,537</u>	<u>1,786,243</u>	<u>(429,590)</u>	<u>8,815,190</u>
Total	117,018,428	8,218,076	(734,168)	124,502,336
Less accumulated depreciation	(37,986,386)	(3,093,782)	508,564	(40,571,604)
Construction in progress	<u>1,440,914</u>	7,150,294	(7,597,867)	<u>993,341</u>
	<u>\$ 80,472,956</u>			<u>\$ 84,924,073</u>

	Balance October 1, 2009	Additions	Retirements	Balance September, 30 2010
Land and land rights	\$ 471,235	\$ 1,336,800	\$ -	\$ 1,808,035
Structures and improvements	115,215,911	9,896,548	(95,255)	125,017,204
Furniture, equipment and other	<u>8,815,190</u>	<u>325,315</u>	<u>(132,572)</u>	<u>9,007,933</u>
Total	124,502,336	11,558,663	(227,827)	135,833,172
Less accumulated depreciation	(40,571,604)	(3,343,837)	205,239	(43,710,202)
Construction in progress	<u>993,341</u>	2,325,286	(1,940,033)	<u>1,378,594</u>
	<u>\$ 84,924,073</u>			<u>\$ 93,501,564</u>

NOTE 14 - UTILITY PLANT IN SERVICE - CONTINUED

WATER SYSTEM

	Balance October 1, 2008	Additions	Retirements	Balance September, 30 2009
Land and land rights	\$ 1,775,464	\$ 1,220,729	\$ -	\$ 2,996,193
Structures and improvements	211,247,619	22,783,922	(376,392)	233,655,149
Furniture, equipment and other	<u>5,377,243</u>	<u>2,528,884</u>	<u>(222,039)</u>	<u>7,684,088</u>
Total	218,400,326	26,533,535	(598,431)	244,335,430
Less accumulated depreciation	(78,563,387)	(5,207,041)	525,295	(83,245,133)
Construction in progress	<u>7,778,581</u>	19,713,949	(24,709,618)	<u>2,782,912</u>
	<u>\$ 147,615,520</u>			<u>\$ 163,873,209</u>

	Balance October 1, 2009	Additions	Retirements	Balance September, 30 2010
Land and land rights	\$ 2,996,193	\$ -	\$ (1,250,000)	\$ 1,746,193
Structures and improvements	233,655,149	2,832,368	(5,002,485)	231,485,032
Furniture, equipment and other	<u>7,684,088</u>	<u>556,621</u>	<u>(66,672)</u>	<u>8,174,037</u>
Total	244,335,430	3,388,989	(6,319,157)	241,405,262
Less accumulated depreciation	(83,245,133)	(5,963,066)	1,135,448	(88,072,751)
Construction in progress	<u>2,782,912</u>	8,954,840	(3,287,587)	<u>8,450,165</u>
	<u>\$ 163,873,209</u>			<u>\$ 161,782,676</u>