



Component Unit - Financial Statements
September 30, 2008 and 2007

City of Huntsville Utilities

Electric, Natural Gas, and Water Systems

Energy for Your Future

MANAGEMENT DISCUSSION AND ANALYSIS

Fiscal Year 2008

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. These statements offer short and long term financial information about their activities. The Statements of Net Assets 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 cash was used for, and what was the change in the cash balances during the reporting period.

Net Assets

Table A-1
Condensed Statement of Net Assets
(000's)

	<u>FY 2008</u>	<u>FY 2007</u>	<u>\$ Change</u>
Current and Other Assets	\$124,682	\$ 125,116	(\$ 434)
Capital Assets (Net)	<u>225,047</u>	<u>213,089</u>	<u>11,958</u>
Total Assets	349,729	338,205	11,524
Long-Term Debt Outstanding	22,278	23,278	(\$ 1,000)
Other Liabilities	<u>84,130</u>	<u>82,630</u>	<u>1,500</u>
Total Liabilities	106,408	105,908	500
Invested in Capital Assets,			
Net of Related Debt	201,820	188,427	13,393
Restricted	6,838	6,870	(32)
Unrestricted	<u>34,664</u>	<u>36,999</u>	<u>(2,335)</u>
Total Net Assets	\$243,321	\$ 232,296	11,025

Current and Other Assets remained relatively flat. The details show a reduction in Cash and Cash Equivalents of \$4.8 million. The main reason for this was the Board's designation of an additional \$3.5 million to the internal Construction Fund and the Renewal and Replacement Fund. The bulk of this designation is in anticipation of the capital expense to replace all of the System's software. The current software is a 30 year-old legacy system whose language and operating system are no longer supported. Phase I of the project is all back-office functions and will be completed in fiscal year 2009. SAP Software has been selected for Phase I. Phase II of the project will be the CIS and billing functions. Our cash position is almost 77 days of budgeted operating and capital expenses. The Board's desired minimum is approximately 45 days of budgeted operating and capital expenses.

Capital Assets continue to grow at a faster than normal pace with the continued strengthening of the System with additional substations. Capital Assets (Net) increased by 12 million dollars. There was \$20.0 million of capital work closed to plant this year, the "net" figure being the offset by depreciation expense. A refinancing bond issuance was made this fiscal year to lower our overall cost of borrowing. At that time, Moody's assigned an upgraded rating on the Electric System bond from Aa3 to an Aa2.

Net Assets

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

	<u>FY 2008</u>	<u>FY 2007</u>	<u>\$ Change</u>
Operating Revenues	\$403,604	\$ 365,240	\$ 38,364
Non-Operating Revenues	2,921	4,939	(2,018)
Total Revenues	406,525	370,179	35,346
Depreciation Expense	11,419	10,831	588
Other Operating Expense	371,313	330,301	41,012
Non-Operating Expense	2,632	2,588	44
Total Expenses	385,364	343,720	41,644
Income (Loss) Before Transfers	21,161	26,459	(6,298)
Transfers Out – Tax Equivalents	<u>(10,136)</u>	<u>(9,689)</u>	<u>(\$447)</u>
Change in Net Assets	11,025	16,771	(5,746)
Beginning Net Assets	<u>232,297</u>	<u>215,526</u>	
Ending Net Assets	\$243,321	\$ 232,297	

The change in Operating Revenues was an increase of \$38.3 million (+10.5%) due to the pass-through to retail of TVA's wholesale quarterly fuel cost adjustments (FCA's). The System experienced another mild winter period but FY2008 was another drought year with slightly less extreme summer temperatures than FY2007. Our customer growth for the area increased by 2.2% this year. Bad debt write-offs to revenues was .04% (.0004). Non-Operating Revenues declined \$2 million due to the falling interest rates lowering the income on reserves and cash on hand.

Other Operating Expense increased \$41.0 million, \$38.2 million of which was for wholesale power from TVA. Purchases of kWh increased only 0.4% with the balance of the increase due to FCA's. Also, Other Operating Expense includes Administrative and General Expenses which increased \$2.1 million. Of that, \$1.4 million was a \$787,000 increase in this year's actual medical expenses and \$650,000 from an accrual implementing GASB 44 and GASB 45, Other Post Employment Benefits (OPEB).

CITY OF HUNTSVILLE NATURAL GAS SYSTEM

Net Assets

Table B-1
Condensed Statement of Net Assets
 (000's)

	<u>FY 2008</u>	<u>FY 2007</u>	<u>\$ Change</u>
Current and Other Assets	\$ 46,555	\$ 45,005	\$ 1,550
Capital Assets (Net)	80,473	77,416	3,057
Total Assets	127,028	122,421	4,607
Long-term Debt Outstanding	9,415	9,840	(425)
Other Liabilities	15,287	12,449	2,838
Total Liabilities	24,702	22,289	2,413
Invested in Capital Assets, Net of Related Debt	70,771	67,314	3,457
Restricted	4,084	9,251	(5,167)
Unrestricted	27,471	23,566	3,905
Total Net Assets	\$102,326	\$ 100,132	\$ 2,195

Although the total Current and Other Assets did not change significantly, changes to the accounts therein were notable. The use of \$5.2 million of bond proceeds for capital projects eased the demand on current cash flow. Cash and Cash Equivalents increased by \$5.4 million, and the investment in stored gas increased by \$1.1 million. This was a quantity increase of 7,233 MMBTU and a price increase of \$1.14 per MMBTU. This increase is still within our current rate structure.

Capital Assets (Net) grew by \$3.5 million as bond proceeds (Construction Funds – Restricted decrease of \$1.6 million) were expended on capital improvements of the system. The main portions of these funds were expended toward the completion of the eastern loop while \$5.3 million was closed to plant from Construction Work in Progress.

Net Assets

Table B-2

Condensed Statement of Revenues, Expenses and Changes in Net Assets (000's)

	<u>FY 2008</u>	<u>FY 2007</u>	<u>\$ Change</u>
Operating Revenues	\$ 56,411	\$ 58,429	(\$ 2,018)
Non-Operating Revenues	1,007	1,628	(621)
Other Non-Operating Revenues	0	11,600	(11,600)
Total Revenues	57,418	71,657	(14,239)
Depreciation Expense	2,380	2,267	113
Other Operating Expense	49,811	52,460	(2,649)
Non-Operating Expense	391	314	77
Total Expenses	52,582	55,041	(2,459)
Income (Loss) Before Contributions And Transfers	4,836	16,616	(11,780)
Capital Contributions	548	482	66
Transfers Out – Tax Equivalents	<u>(3,190)</u>	<u>(3,330)</u>	<u>140</u>
Change in Net Assets	2,194	13,768	11,574
Beginning Net Assets	<u>100,132</u>	<u>86,364</u>	
Ending Net Assets	<u>\$103,326</u>	<u>\$ 100,132</u>	

Operating Revenues decreased by 2 million dollars reflecting 48,868 Mcf less in sales. Other Non-Operating Revenues declined \$11.6 million due to the settlement of a rare billing dispute in 2007. This billing dispute covered fiscal years 2001 and 2002.

Other Operating Expense decreased by \$2.6 million. The falling prices of natural gas accounted for \$2.2 of the reduction, while we purchased 74,498 less in Mcf reducing operating expenses by another \$40,000. The average price of delivered gas for the year fell from \$10.89 per Mcf to \$10.35 per Mcf. Administrative and General Expenses declined by \$400,000 due to lower legal fees with the billing dispute settled. Gas purchasing remains in-house using trained buyers and a Gas Purchasing Committee comprised of management members. The Committee acts as an advisory committee to the President of the Gas System. Gas purchasing internal controls, policies, and procedures are under constant review by this committee.

It appears that Capital Contributions have reached their base growth level as the continuing high commodity costs bring about less demand for an optional fuel source. Gas tax equivalents are paid to the City of Huntsville and are calculated as 6% of sales revenues.

Net Assets

Table C-1
Condensed Statement of Net Assets
(000's)

	<u>FY 2008</u>	<u>FY 2007</u>	<u>\$ Change</u>
Current and Other Assets	\$ 42,564	\$ 16,074	\$ 26,490
Capital Assets (Net)	147,616	134,539	13,077
Total Assets	190,179	150,613	39,566
Long-Term Debt Outstanding	43,930	16,813	27,117
Other Liabilities	10,056	7,830	2,226
Total Liabilities	53,986	24,643	29,343
Invested in Capital Assets, Net of Related Debt	103,312	116,396	(13,084)
Restricted	24,601	2,920	21,681
Unrestricted	8,281	6,654	1,627
Total Net Assets	\$136,194	\$ 125,970	\$ 10,224

Current and Other Assets increased by \$26.5 million and Long-Term Debt Outstanding by \$27.1 million. These large increases are directly attributable to the issuance of Bonds. The main project of these proceeds, the year-end balance in "Restricted" capital assets, was the expansion of an existing water purification plant. The Water System's Bond Ratings were raised by both Standard & Poor's and Moody's, (AA+ and Aa2 respectively). Invested in Capital Assets, Net of Related Debt declined reflecting the bond issue, while \$14.2 million in capital work-in-progress was closed to plant this year.

Cash and Cash Equivalents increased by \$3.2 million. The city council passed, on recommendation of the Board, two rate increases in succeeding years, stabilizing us for the increased debt service and as a way to set aside monies for future water purification. As the plants have been expanded to their practical limits, the next water purification will come from a new plant built on the Tennessee River.

Net Assets

Table C-2
Condensed Statement of Revenues, Expenses and Changes in Net Assets
(000's)

	<u>FY 2008</u>	<u>FY 2007</u>	<u>\$ Change</u>
Operating Revenues	\$ 24,536	\$ 23,081	\$ 1,455
Non-Operating Revenues	373	559	(186)
Total Revenues	24,909	23,640	1,269
Depreciation Expense	4,340	4,148	192
Other Operating Expense	14,542	12,355	2,187
Non-Operating Expense	1,126	1,096	30
Total Expenses	20,008	17,599	2,409
Income (Loss) Before Contributions And Transfers	4,901	6,041	(1,140)
Capital Contributions	6,655	5,268	1,387
Transfers Out – Tax Equivalents	(1,331)	(1,264)	(67)
Change in Net Assets	10,224	10,046	178
Beginning Net Assets	<u>125,970</u>	<u>115,924</u>	
Ending Net Assets	<u>\$136,194</u>	<u>\$ 125,970</u>	

Fiscal Year 2008 was considered another drought year. Total volume of sales declined by 6% from the previous year, but FY2008 still had the second highest water sales, in gallons, on record. While the gallons sold decreased, revenues increased due to the implementation of new rates.

Other Operating Expenses increased by \$2.2 million. Medical expenses reflected a \$581,000 increase as health coverage went up and GASB 43 and 45 were implemented. GASB 43 and 45 start the 30-year process of getting Other Post Employment Benefits (OPEB) recognized on and in the financial statements of the Utilities. This is discussed further in the footnotes to the financials. The cost of chemicals used in the treatment of the water increased \$200,000 this year, a 15% increase. Higher electric bills accounted for another \$200,000 of the increase. Operations and maintenance of the distribution system expenses were up \$600,000 or 17%. A review of the details of these accounts shows a fairly even distribution of these increases. Pension expense continued to grow as the value of investments in our defined benefit plan continued to decline. This is a percentage of payroll, set by the Employee's Retirement System of Alabama based on the Water System's estimated liability vs. its assets in the system. If the System's assets and earnings do not keep pace with the liabilities, additional contributions are required from the employer based on the Retirement System's actuarial studies.

Capital Contributions increased again this year by \$1.3 million with continued growth in our service area. We do not believe that this level of growth will continue at this pace due to the current economy.


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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, 2008, 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, 2007 financial statements were examined by other auditors whose report dated January 28, 2008 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, 2008, 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 8 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

January 20, 2009

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

**COMPONENT UNIT
FINANCIAL STATEMENTS**

SEPTEMBER 30, 2008 AND 2007

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CITY OF HUNTSVILLE ELECTRIC SYSTEM

STATEMENTS OF NET ASSETS SEPTEMBER 30, 2008 AND 2007

ASSETS

	2008	2007
Current Assets		
Cash and cash equivalents	\$ 50,400,856	\$ 55,203,229
Accounts receivable - trade, net of allowance for doubtful accounts of \$370,801 in 2008 and \$376,392 in 2007	26,896,561	27,791,112
Materials and supplies	5,037,906	4,353,253
Prepaid expenses	334,043	210,159
Accrued interest, rent and other receivables	2,502,585	1,918,036
Total Current Assets	85,171,951	89,475,789
Restricted and Board Designated Assets (Note 1)		
Emergency Funds - Designated	3,000,000	3,000,000
Insurance Funds - Designated	1,042,233	1,042,233
Construction Funds - Designated	11,148,974	10,764,377
Renewal & Replacement Funds - Designated	16,232,388	13,142,922
Other special funds - Designated	320,325	324,464
Improvement Funds - Bond Restricted	500,000	500,000
Debt Service Funds - Bond Restricted	1,632,722	1,636,758
Reserve Debt Service Funds - Bond Restricted	2,705,428	2,705,428
Worker's Compensation Funds - Restricted	2,000,000	2,028,129
Total Restricted Assets and Designated Assets	38,582,070	35,144,311
Deferred Charges		
Unamortized bond expense (Note 5)	800,338	367,829
Other deferred charges	128,100	128,100
Total Deferred Charges	928,438	495,929
Utility Plant (Note 1)		
Plant in service	370,897,592	354,762,703
Construction in progress	14,759,234	9,418,873
Retirement work in process	3,891	3,891
	385,660,717	364,185,467
Less: Accumulated depreciation	(160,614,128)	(151,096,296)
Total Utility Plant	225,046,589	213,089,171
TOTAL ASSETS	\$ 349,729,048	\$ 338,205,200

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

**STATEMENTS OF NET ASSETS
SEPTEMBER 30, 2008 AND 2007**

NET ASSETS AND LIABILITIES

	2008	2007
Current Liabilities		
Accounts payable - trade	\$ 36,036,511	\$ 37,600,680
Accounts payable - other utility departments (Note 1)	7,935,127	8,622,487
Customer meter deposits, including accrued interest of \$9,944,095 in 2008 and \$9,694,878 in 2007	33,171,667	30,639,815
Compensated absences	3,074,154	2,873,305
Other current liabilities	2,034,900	1,014,415
Total Current Liabilities	82,252,359	80,750,702
 Liabilities Payable from Restricted Assets		
Current maturities of long-term debt (Note 5)	1,545,000	1,490,000
Interest payable	332,380	389,598
Total Liabilities Payable from Restricted Assets	1,877,380	1,879,598
 Long-Term Debt (Note 5)		
Electric revenue bonds, excluding current portion	22,235,000	23,535,000
Unamortized bond premium	264,012	0
Less: Unamortized debt retirement	(221,043)	(256,881)
Total Long-Term Debt	22,277,969	23,278,119
 Total Liabilities	 106,407,708	 105,908,419
 Net Assets		
Invested in capital assets, net of related debt	201,819,678	188,427,383
Restricted	6,838,150	6,870,315
Unrestricted	34,663,512	36,999,083
Total Net Assets	243,321,340	232,296,781
 TOTAL NET ASSETS AND LIABILITIES	 \$ 349,729,048	 \$ 338,205,200

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 THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007

	2008	2007
Operating Revenue		
Residential	\$ 186,744,898	\$ 171,859,287
Large commercial and industrial	172,689,166	152,356,341
Small commercial	29,857,178	27,391,807
Public street and highway lighting	3,900,168	3,564,094
Other operating revenue	10,412,783	10,068,202
Total Operating Revenue	403,604,193	365,239,731
Operating Expenses		
Purchased power	342,194,033	304,030,993
Transmission	73,317	182,258
Distribution	14,514,261	13,741,720
Customer accounting	4,592,577	4,571,218
Administrative and general	8,960,600	6,849,649
Depreciation	11,419,265	10,830,593
Payroll taxes	977,948	924,855
Total Operating Expenses	382,732,001	341,131,286
Operating Income	20,872,192	24,108,445
Other Revenue and (Expenses)		
Interest income	2,920,658	4,938,997
Interest expense	(2,587,172)	(2,555,418)
Amortization of bond discount	(44,783)	(32,628)
Total Other Revenue (Expenses)	288,703	2,350,951
Change in Net Assets before Transfers	21,160,895	26,459,396
Transfers Out - Tax Equivalent	(10,136,334)	(9,688,723)
Change in Net Assets	11,024,561	16,770,673
Beginning Net Assets	232,296,781	215,526,108
Ending Net Assets	\$ 243,321,342	\$ 232,296,781

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

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007

	2008	2007
CASH FLOWS FROM (USED FOR) OPERATING ACTIVITIES		
Received from customers	\$ 404,498,744	\$ 363,188,458
Paid to suppliers for goods and services	(359,176,447)	(304,114,266)
Paid to employees for goods and services	(11,991,880)	(17,927,667)
Net cash flows from (used for) operating activities	33,330,417	41,146,525
CASH FLOWS FROM (USED FOR) NONCAPITAL FINANCING ACTIVITIES		
Transfers out - tax equivalent	(10,136,334)	(9,688,723)
Net cash provided from (used for) noncapital financing activities	(10,136,334)	(9,688,723)
CASH FLOWS FROM (USED FOR) INVESTING ACTIVITIES		
Interest income earned on investments	2,920,658	4,938,997
Net cash provided (used for) from investing activities	2,920,658	4,938,997
CASH FLOWS FROM (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES		
Payment of principal on long-term debt	(1,530,000)	(1,505,000)
Retirement of long-term debt	(12,910,000)	0
Proceeds	13,459,012	0
Bond issue costs	(477,292)	0
Change in deferred charges	0	0
Additions to plant in service	(23,376,686)	(24,036,957)
Changes in special funds, net	(3,437,759)	830,865
Interest paid	(2,644,390)	(2,569,693)
Net cash from (used for) capital and related financing activities	(30,917,115)	(27,280,785)
INCREASE (DECREASE) IN CASH	(4,802,374)	9,116,014
CASH AT BEGINNING OF YEAR	55,203,230	46,087,216
CASH AT END OF YEAR	\$ 50,400,856	\$ 55,203,230

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, 2008 AND 2007

	2008	2007
RECONCILIATION OF OPERATING INCOME TO NET CASH		
FLOWS FROM OPERATING ACTIVITIES		
Operating Income	\$ 20,872,192	\$ 24,108,445
Adjustments to reconcile operating income to net cash flows from operating activities:		
Depreciation and amortization included in operating	11,455,103	10,873,030
Change in accounts receivable - customer	894,551	(2,051,273)
Change in accounts receivable - other	(584,549)	1,131,078
Change in inventory	(684,653)	(281,386)
Change in prepaid expenses	(123,884)	13,835
Change in accounts payable	(2,251,529)	4,220,349
Change in customer deposits	2,531,852	2,856,707
Change in accrued expenses and other current liabilities	1,221,334	275,740
Net Adjustments	12,458,225	17,038,080
NET CASH FLOWS FROM OPERATING ACTIVITIES	\$ 33,330,417	\$ 41,146,525

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

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CITY OF HUNTSVILLE NATURAL GAS SYSTEM

STATEMENTS OF NET ASSETS SEPTEMBER 30, 2008 AND 2007

ASSETS

	2008	2007
Current Assets		
Cash and cash equivalents	\$ 19,648,828	\$ 14,224,082
Accounts receivable - trade, net of allowance for doubtful accounts of \$64,014 in 2008 and \$54,725 in 2007	1,086,198	1,223,653
Stored gas	8,171,279	7,049,311
Materials and supplies	847,874	523,058
Prepaid expenses	198,804	95,116
Accrued interest, rent and other receivables	304,295	1,104,143
Total Current Assets	30,257,278	24,219,363
Restricted Assets and Board Designated Assets		
Insurance Funds - Designated	997,670	997,670
Construction Funds - Designated	1,048,521	6,217,100
Renewal & Replacement Funds - Designated	5,091,662	4,880,337
Construction Funds - Restricted	5,920,663	5,440,663
Debt Service Funds - Restricted	818,244	818,244
Bond Sinking Funds - Restricted	136,664	139,169
Worker's Compensation Fund - Restricted	2,080,417	2,076,731
Restricted Assets and Designated Assets	16,093,841	20,569,914
Other Assets		
Unamortized debt expense	203,471	215,558
Utility Plant (Note 1)		
Plant in service	117,018,428	111,105,148
Construction in progress	1,440,914	1,584,565
	118,459,342	112,689,713
Less: Accumulated depreciation	(37,986,386)	(35,273,494)
Total Utility Plant	80,472,956	77,416,219
TOTAL ASSETS	\$ 127,027,546	\$ 122,421,054

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

**STATEMENTS OF NET ASSETS
SEPTEMBER 30, 2008 AND 2007**

NET ASSETS AND LIABILITIES

	2008	2007
Current Liabilities		
Accounts payable - trade	\$ 4,994,477	\$ 2,901,981
Customer meter deposits, including accrued interest of \$2,282,760 in 2008 and \$2,130,788 in 2007	8,193,573	7,657,932
Compensated absences	1,064,549	965,170
Customer advances for construction	0	162,424
Other current liabilities	544,053	284,204
Total Current Liabilities	14,796,652	11,971,711
Liabilities Payable from Restricted Assets		
Current maturities of revenue bonds	425,000	410,000
Interest payable	65,089	67,651
Total Liabilities Payable from Restricted Assets	490,089	477,651
Long-Term Debt		
Revenue bonds - less current maturity	9,415,000	9,840,000
Total Liabilities	24,701,741	22,289,362
Net Assets		
Invested in capital assets, net of related debt	70,771,338	67,314,126
Restricted	4,083,846	9,251,244
Unrestricted	27,470,621	23,566,322
Total Net Assets	102,325,805	100,131,692
TOTAL NET ASSETS AND LIABILITIES	\$ 127,027,546	\$ 122,421,054

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

CITY OF HUNTSVILLE NATURAL GAS SYSTEM

STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET ASSETS FOR THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007

	2008	2007
Operating Revenue		
Residential	\$ 22,772,234	\$ 24,312,037
Commercial	26,356,217	26,702,910
Industrial	4,029,753	4,487,065
Governmental	0	0
Other operating revenue	3,252,758	2,926,497
Total Operating Revenue	56,410,962	58,428,509
Operating Expenses		
Purchased gas	42,107,776	45,103,947
Production	10,660	16,402
Distribution	3,779,012	3,141,327
Customer accounting	731,228	653,763
Administrative and general	2,850,316	3,266,608
Depreciation	2,379,840	2,267,102
Payroll taxes	332,288	277,672
Total Operating Expenses	52,191,120	54,726,821
Operating Income	4,219,842	3,701,688
Other Revenue and (Expenses)		
Interest income	1,006,532	1,628,199
Loss on sale of fixed assets	0	0
Interest expense	(378,858)	(302,166)
Amortization of debt discount	(12,084)	(12,084)
Total Other Revenue (Expenses)	615,590	1,313,949
Change in Net Assets Before Capital Contributions And Transfers	4,835,432	5,015,637
Capital Contributions	548,497	482,415
Other Non-Operating Income	0	11,600,000
Transfers Out - Tax Equivalent	(3,189,816)	(3,330,386)
Change in Net Assets	2,194,113	13,767,666
Beginning Net Assets	100,131,692	86,364,026
Ending Net Assets	\$ 102,325,805	\$ 100,131,692

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

**STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007**

	2008	2007
CASH FLOWS FROM (USED FOR) OPERATING ACTIVITIES		
Received from customers	\$ 56,548,417	\$ 58,539,053
Paid to suppliers for goods and services	(42,785,611)	(40,896,945)
Paid to employees for goods and services	(4,951,352)	(6,461,403)
Net cash flows from (used for) operating activities	8,811,454	11,180,705
CASH FLOWS FROM (USED FOR) NONCAPITAL FINANCING ACTIVITIES		
Transfers out - tax equivalent	(3,189,816)	(3,330,386)
Proceeds from settlement of lawsuit	11,600,000	
Net cash from (used for) noncapital financing activities	(3,189,816)	8,269,614
CASH FLOWS FROM (USED FOR) INVESTING ACTIVITIES		
Interest income earned on investments	1,006,532	1,628,199
Net cash from (used for) investing activities	1,006,532	1,628,199
CASH FLOWS FROM (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES		
Payment of principal on long-term debt	(410,000)	(395,000)
Additions to plant in service	(5,439,136)	(5,133,714)
Debt expense paid	0	0
Capital contributions	548,497	482,415
Changes in special funds, net	4,476,073	(5,158,684)
Interest paid and expensed	(378,858)	(302,166)
Net cash from (used for) capital and related financing activities	(1,203,424)	(10,507,149)
INCREASE (DECREASE) IN CASH	5,424,746	10,571,369
CASH AT BEGINNING OF YEAR	14,224,082	3,652,713
CASH AT END OF YEAR	\$ 19,648,828	\$ 14,224,082

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

CITY OF HUNTSVILLE NATURAL GAS SYSTEM

STATEMENTS OF CASH FLOWS - CONTINUED FOR THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007

	2008	2007
RECONCILIATION OF OPERATING INCOME TO NET CASH		
FLOWS FROM OPERATING ACTIVITIES		
Operating Income	\$ 4,219,842	\$ 3,701,688
Adjustments to reconcile operating income to net cash flows from operating activities:		
Depreciation and amortization included in operating	2,379,840	2,267,102
Change in accounts receivable - customer	137,455	110,544
Change in accounts receivable - other	799,848	(53,997)
Change in inventory	(1,446,784)	3,021,255
Change in prepaid expenses	(103,688)	127,021
Change in accounts payable	2,092,496	865,942
Change in customer deposits	535,641	1,040,361
Change in accrued expenses and other current liabilities	196,804	100,789
Net Adjustments	4,591,612	7,479,017
NET CASH FLOWS FROM OPERATING ACTIVITIES	\$ 8,811,454	\$ 11,180,705

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

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

CITY OF HUNTSVILLE WATER WORKS

STATEMENTS OF NET ASSETS SEPTEMBER 30, 2008 AND 2007

ASSETS

	2008	2007
Current Assets		
Cash and cash equivalents	\$ 6,899,575	\$ 3,733,329
Accounts receivable - trade, net of allowance for doubtful accounts of \$32,295 in 2008 and \$33,598 in 2007	1,920,652	1,988,605
Materials and supplies	1,615,570	1,556,758
Prepaid expenses	211,579	59,894
Total Current Assets	10,647,376	7,338,586
Restricted Assets and Board Designated Assets		
Construction Funds - Designated	3,681,358	3,742,605
Construction Funds - Restricted	18,345,721	0
Insurance Funds - Designated	555,485	555,485
Debt Service Funds - Bond Restricted	4,808,892	1,448,575
Worker's Compensation Funds - Restricted	1,446,355	1,470,993
Renewal and Replacement Funds - Designated	1,639,535	1,300,092
Total Restricted Assets and Board Designated Assets	30,477,346	8,517,750
Deferred Charges		
Unamortized bond expense (Note 5)	1,109,883	213,231
Other deferred charges	329,298	4,073
Total Deferred Charges	1,439,181	217,304
Utility Plant (Note 1)		
Plant in service	218,400,326	199,348,711
Construction in progress	7,778,581	9,966,717
	226,178,907	209,315,428
Less: Accumulated depreciation	(78,563,387)	(74,776,033)
Total Utility Plant	147,615,520	134,539,395
TOTAL ASSETS	\$ 190,179,423	\$150,613,035

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

**STATEMENTS OF NET ASSETS
SEPTEMBER 30, 2008 AND 2007**

NET ASSETS AND LIABILITIES

	2008	2007
Current Liabilities		
Accounts payable - trade	\$ 1,751,985	\$ 423,939
Intercompany payables	366,154	354,710
Customer meter deposits, including accrued interest of \$1,062,386 in 2008 and \$1,157,788 in 2007	4,108,699	3,840,327
Customer advances for construction	153,520	153,823
Compensated absences	1,270,112	1,165,033
Other current liabilities	921,547	348,527
Total Current Liabilities	8,572,017	6,286,359
Liabilities Payable from Restricted Assets		
Current maturities of long-term debt (Note 5)	700,000	1,185,000
Interest payable	784,215	358,312
Total Liabilities Payable from Restricted Assets	1,484,215	1,543,312
Long-Term Debt (Note 5)		
Water revenue bonds, excluding current portion	42,960,000	17,245,000
Unamortized bond premium	1,340,790	0
Less: Unamortized bond retirement	(371,364)	(431,584)
Total Long-Term Debt	43,929,426	16,813,416
Total Liabilities	53,985,658	24,643,087
Net Assets		
Invested in capital assets, net of related debt	103,311,762	116,395,898
Restricted	24,600,968	2,919,568
Unrestricted	8,281,035	6,654,482
Total Net Assets	136,193,765	125,969,948
TOTAL NET ASSETS AND LIABILITIES	\$ 190,179,423	\$ 150,613,035

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

CITY OF HUNTSVILLE WATER WORKS

STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET ASSETS FOR THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007

	2008	2007
Operating Revenue		
Residential	\$ 11,988,479	\$ 11,127,051
Industrial	1,735,818	1,674,902
Commercial	6,142,069	5,365,353
Government	1,389,560	1,515,095
Fire hydrants	717,325	649,080
Other operating revenue	2,562,378	2,749,239
Total Operating Revenue	24,535,629	23,080,720
Operating Expenses		
Purification	950,986	754,902
Pumping	3,653,452	3,373,630
Distribution	4,229,023	3,625,171
Customer accounting	1,569,782	1,245,194
Administrative and general	3,664,017	2,934,269
Depreciation	4,340,355	4,148,119
Payroll taxes	474,979	421,460
Total Operating Expenses	18,882,594	16,502,745
Operating Income	5,653,035	6,577,975
Other Revenue and (Expenses)		
Interest income	373,341	558,925
Interest expense	(1,101,782)	(1,076,342)
Amortization of bond discount	(23,955)	(19,380)
Total Other Revenue (Expenses)	(752,396)	(536,797)
Change in Net Assets before Capital Contributions and Transfers	4,900,639	6,041,178
Capital Contributions	6,654,565	5,268,421
Transfers Out - Tax Equivalent	(1,331,386)	(1,263,890)
Change in Net Assets	10,223,818	10,045,709
Beginning Net Assets	125,969,948	115,924,239
Ending Net Assets	\$ 136,193,766	\$125,969,948

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

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007

	2008	2007
CASH FLOWS FROM (USED FOR) OPERATING ACTIVITIES		
Received from customers	\$ 24,603,582	\$ 22,921,840
Paid to suppliers for goods and services	(6,470,906)	(5,474,953)
Paid to employees for goods and services	(5,935,647)	(6,818,442)
Net cash flows from (used for) operating activities	12,197,029	10,628,445
CASH FLOWS FROM (USED FOR) NONCAPITAL FINANCING ACTIVITIES		
Transfers out - tax equivalents	(1,331,386)	(1,263,890)
Net cash flows from (used for) noncapital financing activities	(1,331,386)	(1,263,890)
CASH FLOWS FROM (USED FOR) INVESTING ACTIVITIES		
Deferred charges	(325,225)	193,017
Interest income earned on investments	373,341	558,925
Net cash from (used for) investing activities	48,116	751,942
CASH FLOWS FROM (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES		
Payment of principal on long-term debt	(1,185,000)	(1,135,000)
Proceeds	45,000,790	0
Bond issue costs	(920,607)	0
Retirement	(17,245,000)	0
Customer advances	(303)	6,686
Additions to plant in service	(17,416,483)	(11,888,204)
Capital contributions	6,654,565	5,268,421
Changes in special funds, net	(21,959,596)	(5,506,666)
Interest paid	(675,879)	(1,098,214)
Net cash from (used for) capital and related financing activities	(7,747,513)	(14,352,977)
INCREASE (DECREASE) IN CASH	3,166,246	(4,236,480)
CASH AT BEGINNING OF YEAR	3,733,329	7,969,809
CASH AT END OF YEAR	\$ 6,899,575	\$ 3,733,329

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

CITY OF HUNTSVILLE WATER WORKS

STATEMENTS OF CASH FLOWS - CONTINUED FOR THE YEARS ENDED SEPTEMBER 30, 2008 AND 2007

	2008	2007
RECONCILIATION OF OPERATING INCOME TO NET CASH		
 FLOWS FROM OPERATING ACTIVITIES		
Operating Income	\$ 5,653,035	\$ 6,577,975
Adjustments to reconcile operating income to net cash flows from operating activities:		
Depreciation and amortization, included in operating	4,400,575	4,208,340
Change in accounts receivable - customer	67,953	(158,880)
Change in inventory	(58,812)	(14,884)
Change in prepaid expenses	(151,685)	(17,173)
Change in accounts payable	1,328,048	(399,914)
Change in customer deposits	268,372	303,070
Change in accrued expenses and other current liabilities	689,543	129,911
Net Adjustments	6,543,994	4,050,470
NET CASH FLOWS FROM OPERATING ACTIVITIES	\$ 12,197,029	\$ 10,628,445

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, 2008 AND 2007

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 pronouncements issued before November 30, 1989 and all pronouncements of the Governmental Accounting Standards Board (GASB) issued after November 30, 1989.

Energy Tip Wash clothes with cold water. Not only will this save energy by not heating water, but cold water is gentler on clothes and may extend the life of your garments.

CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

SEPTEMBER 30, 2008 AND 2007

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, 2008 and 2007.

Energy Tip Install energy-efficient showerheads. You will save on energy, water, and sewer bills if the new showerhead reduces the flow to less than two gallons per minute.

CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

SEPTEMBER 30, 2008 AND 2007

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

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.

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 does not accrue unbilled receivables from the most recent meter reading to 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.

Energy Tip Keep drapes and blinds on your windows closed during the summer to reduce solar heat gain. During winter months, leave south side windows uncovered to allow the sun to warm your home naturally.

**CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS
NOTES TO THE FINANCIAL STATEMENTS - CONTINUED**

SEPTEMBER 30, 2008 AND 2007

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

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.

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.

Energy Tip Only light rooms and areas where you actually need light. Turn off light switches as you leave the room. Use lamps and other "task" lighting where you need it instead of lighting the entire room.

CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

SEPTEMBER 30, 2008 AND 2007

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, 2008 and 2007 are as follows:

	2008	2007
Electric System	\$ 10,136,334	\$ 9,688,723
Natural Gas System	3,189,816	3,330,386
Water System	1,331,386	1,263,890

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, 2006 and 2005 are as follows:

	Accrued Annual Leave		Accrued Sick Leave	
	2008	2007	2008	2007
Electric System	\$ 1,765,524	\$ 1,660,787	\$ 1,308,630	\$ 1,212,518
Natural Gas System	578,275	532,204	486,274	432,965
Water System	666,858	614,731	603,254	550,302

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.

Energy Tip Defrost manual freezers before the frost exceeds a quarter inch thick. Frost buildup makes the freezer work harder, running longer than necessary.

CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

SEPTEMBER 30, 2008 AND 2007

NOTE 4 - DEFINED BENEFIT PENSION PLAN AND DESCRIPTION - CONTINUED

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 2008 and 2007, the Utilities were required to contribute the following percentages of gross payroll to the plan:

	2008	2007
Electric System	16.68%	14.37%
Natural Gas System	10.79%	9.73%
Water System	11.54%	9.53%

Based on an actuarial valuation completed as of September 30, 2007, the Annual Pension Cost for the System is as follows:

	Annual Pension Cost (APC) 2007	Annual Pension Cost (APC) 2006	Percentage of APC Contributed 2007 and 2006
Electric System	\$1,351,186	\$1,059,692	100%
Natural Gas System	1,511,970	1,176,530	100%
Water System	467,736	339,593	100%

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, 2005 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, 2007 was 20 years for the Gas System, 19 years for the Water System and 18 years for the Electric System.

Energy Tip Take short showers instead of baths. Not only will you save water, but you will save on the energy it takes to heat the water. A five-minute shower is usually enough time to get clean.

**CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS
NOTES TO THE FINANCIAL STATEMENTS - CONTINUED**

SEPTEMBER 30, 2008 AND 2007

NOTE 4 - DEFINED BENEFIT PENSION PLAN AND DESCRIPTION - CONTINUED

Based on an actuarial valuation done in September 30, 2007, 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		Covered Payroll	UAAL Percentage of Payroll
			Under/(Over) AAL (UAAL)	Funded Ratio		
2003	\$26,956,436	\$35,183,389	\$8,226,953	76.6%	\$7,531,556	109.2%
2004	\$27,424,773	\$37,059,535	\$9,634,762	74.0%	\$7,651,882	125.9%
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%

Water

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liab. (AAL)	Funding		Covered Payroll	UAAL Percentage of Payroll
			Under/(Over) AAL (UAAL)	Funded Ratio		
2003	\$13,330,583	\$15,267,065	\$1,936,482	87.3%	\$4,023,046	48.1%
2004	\$13,778,429	\$16,325,253	\$2,546,825	84.4%	\$4,076,420	62.5%
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%

Natural Gas

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liab. (AAL)	Funding		Covered Payroll	UAAL Percentage of Payroll
			Under/(Over) AAL (UAAL)	Funded Ratio		
2003	\$32,493,171	\$39,553,224	\$7,060,053	82.2%	\$11,646,101	60.6%
2004	\$33,538,692	\$41,626,982	\$8,088,290	80.6%	\$12,498,042	64.7%
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%

Energy Tip Evaluate the location of your freezer. Freezers use more energy during hot weather if they are located in the garage or other hot area of the building.

CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

SEPTEMBER 30, 2008 AND 2007

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
2009	\$ 430,000	\$ 144,335	4.000%
2010	450,000	126,610	4.100%
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%
	3,445,000		
Current	430,000		
	\$ 3,015,000		

The 2001 issue contained deferred cost of \$75,861 that is being amortized over 13 years. At September 30, 2008, the unamortized deferred cost is \$35,121.

The Electric System is required to establish a cash reserve fund equal to the maximum annual debt service requirement. At September 30, 2008, 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, 2008, 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%

Energy Tip Compact fluorescent bulbs (CFLs) can reduce your lighting cost by 50% or more and they last up to 7 times longer than most incandescent bulbs.

**CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS
NOTES TO THE FINANCIAL STATEMENTS - CONTINUED**

SEPTEMBER 30, 2008 AND 2007

NOTE 5 - LONG TERM DEBT - CONTINUED

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

Electric System Revenue Warrants, Series 1998, were issued in the original amount of \$15,505,000. Bonds in the amount of \$14,650,000 were retired in December 2007. The remaining warrants mature serially on December 1 each year and bear interest according to stated maturity dates as follows:

Fiscal Year	1998 Principal	1998 Interest	1998 Rate
2009	\$ 850,000	\$ 79,190	4.50%
2010	890,000	40,940	4.60%
	1,740,000		
Current	850,000		
	\$ 890,000		

The Electric System is required to establish a cash reserve fund equal to the maximum annual debt service requirement. At September 30, 2008, 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 1998 Warrants coming due on December 1 each year and one sixth (1/6) of the interest due each year. At September 30, 2008, the balance in the funds is in compliance with the indenture. The Electric System Revenue Warrants, Series 1998 is in compliance with Internal Revenue Code Sections 103(b)(2) and 148.

The 1998 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.

1998 Series Warrants maturing in 2008 will be subject to redemption at the option of the City of Huntsville, Alabama, on December 1, 2007, and on any date thereafter, plus accrued interest as follows:

Redemption Dates	Redemption Price
December 1, 2007, through November 30, 2008	102%
December 1, 2008, through November 30, 2009	101%
December 1, 2009, and thereafter	100%

Energy Tip Keep doors closed: Contrary to popular belief, storm doors are usually not very effective as a heat transfer barrier. Try to close the primary door whenever entering or exiting the house.

CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

SEPTEMBER 30, 2008 AND 2007

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	
2009	\$ 265,000	\$ 237,215	3.10%	
2010	275,000	229,000	3.40%	
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%	*
	5,400,000			
Current	265,000			
	\$ 5,135,000			

* - 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:

Redemption Dates	Redemption Price
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:

Energy Tip Use your microwave oven. Microwave ovens are more energy efficient than regular ovens. Up to 70% less energy can be used, food cooks up to 75% faster, and the appliance produces less external heat.

**CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS
NOTES TO THE FINANCIAL STATEMENTS - CONTINUED**

SEPTEMBER 30, 2008 AND 2007

NOTE 5 - LONG TERM DEBT - CONTINUED

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

Redemption Dates	Redemption Price
December 1, 2020	\$440,000
December 1, 2021	465,000
December 1, 2022	490,000

The Electric System is required to establish a cash reserve fund equal to the maximum annual debt service requirement. At September 30, 2008, 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, 2008, 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, 2008, the unamortized deferred cost is \$122,826.

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 ELECTRIC, NATURAL GAS AND WATER SYSTEMS

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

SEPTEMBER 30, 2008 AND 2007

NOTE 5 - LONG TERM DEBT - CONTINUED

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
2009	\$	\$ 527,800	4.00%
2010		527,800	4.00%
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	0		
	\$13,195,000		

The 2007 issue contained deferred cost of \$668,300 that is being amortized over 10 years. At September 30, 2008, the unamortized deferred cost is \$642,392. The 2007 issue also contained a premium of \$264,012 that is being amortized over 10 years. At September 30, 2008, the unamortized premium is \$264,012.

Those of the Series 2007 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 Electric System is required to establish a cash reserve fund equal to the maximum annual debt service requirement. At September 30, 2008, 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, 2008, 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.

Energy Tip ENERGY STAR-rated appliances have been certified by the Department of Energy and the Environmental Protection Agency for efficiency and should be seriously considered when appliances are purchased.

**CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS
NOTES TO THE FINANCIAL STATEMENTS - CONTINUED**

SEPTEMBER 30, 2008 AND 2007

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
2009	\$ 425,000	\$ 390,531	3.25%
2010	440,000	376,719	3.25%
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%
2007	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%
	9,840,000		
Current	425,000		
	\$ 9,415,000		

The Natural Gas System is required to establish a cash reserve fund equal to the maximum annual debt service requirement. At September 30, 2008, 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, 2008, 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.

Energy Tip Energy can be saved by increasing the thermostat setting of the refrigerator or freezer. For normal daily use, the thermostat of a refrigerator can be set between 37-40° and the freezer at 5°.

**CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS
NOTES TO THE FINANCIAL STATEMENTS - CONTINUED**

SEPTEMBER 30, 2008 AND 2007

NOTE 5 - LONG TERM DEBT - CONTINUED

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

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, 2008, the unamortized deferred cost is \$203,471.

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.

Water System Revenue Refunding Warrants, Series 1998

Water System Revenue Warrants, Series 1998, were issued in the original principal amount of \$21,140,000. The warrants were retired on May 1, 2008.

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:

**CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS
NOTES TO THE FINANCIAL STATEMENTS - CONTINUED**

SEPTEMBER 30, 2008 AND 2007

NOTE 5 - LONG TERM DEBT - CONTINUED

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

Fiscal Year	2008 Principal	2008 Interest	2008 Rate	
2009	\$ 700,000	\$ 1,871,618	3.00%	
2010	2,055,000	1,827,724	3.25%	
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%	*
	43,660,000			
Current	700,000			
	\$42,960,000			

* - Term Warrants

Energy Tip Thaw foods in the refrigerator. This is safer than the counter top, and frozen items will help cool the refrigerator and reduce its running time.

CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

SEPTEMBER 30, 2008 AND 2007

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:

Redemption Dates	Redemption Price
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:

Redemption Dates	Redemption Price
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:

Redemption Dates	Redemption Price
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.

Energy Tip Ceiling and floor fans use very little energy and by circulating air can make a room feel 5° cooler in the summer. During the winter ceiling fans can be used to push rising heat back into living areas.

**CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS
NOTES TO THE FINANCIAL STATEMENTS - CONTINUED**

SEPTEMBER 30, 2008 AND 2007

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, 2008, 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 2008 Warrants coming due on November 1 each year and one sixth (1/6) of the interest due each year. At September 30, 2008, the balance in the fund is in compliance with the indenture. The Electric 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, 2008, the unamortized deferred cost is \$1,109,883. The 2008 issue also contained a premium of \$1,340,790 that is being amortized over 25 years. At September 30, 2008, the unamortized premium is \$1,340,790.

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, 2008, the Water System also recognizes deferred costs related to prior year bond retirements in the amount of \$371,364, including related amortization expenses of \$60,220.

Long-Term Debt by System

Principal activity for the year is summarized as follows:

	Beginning	Additions	Retirements	Ending
Electric	\$ 25,025,000	\$ 14,935,000	\$ 16,180,000	\$ 23,780,000
Gas	10,250,000	0	410,000	9,840,000
Water	18,430,000	43,660,000	18,430,000	43,660,000
Total	\$ 53,705,000	\$ 58,595,000	\$ 35,020,000	\$ 77,280,000

Energy Tip Only wash full loads of dishes and clothes and eliminate the energy use of a heater by allowing dishes to dry naturally with air.

CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

SEPTEMBER 30, 2008 AND 2007

NOTE 6 - DEPOSITS WITH FINANCIAL INSTITUTIONS

At September 30, 2008, 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.

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	\$ 11,150	\$ 0	\$ 0
Carrying amounts of:			
Deposits	84,133,626	33,667,542	14,222,308
Investments	4,838,149	2,003,428	23,154,613
Total	\$ 88,982,925	\$ 35,670,970	\$ 37,376,921
Deposits - Cash	\$ 50,400,856	\$ 19,577,130	\$ 6,899,575
Investments:			
Debt service accounts	4,838,149	2,003,428	23,154,613
Other third party restricted	2,000,000	2,080,417	1,446,355
Board designated accounts:			
Renewal and replacement	16,232,388	5,091,662	1,639,535
Construction	11,148,974	5,920,663	3,202,158
Emergency	3,000,000		
Insurance	1,042,233	997,670	555,485
Other	320,325		479,200
Total	\$ 88,982,925	\$ 35,670,970	\$ 37,376,921

At September 30, 2008, the Utilities had the following investments held by a trustee.

<u>Investment</u>	<u>Fair Value</u>	<u>Maturity</u>
Repurchase agreement	\$ 2,705,427	11/30/22
U.S. Treasury Securities Funds	\$ 26,790,763	Average maturity of the fund's securities 397 days or less
	\$ 29,496,190	

Energy Tip Air conditioners that bear the ENERGY STAR label may be 25% more efficient than standard models. Contact a professional for advice on sizing a central air system.

CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

SEPTEMBER 30, 2008 AND 2007

NOTE 6 - DEPOSITS WITH FINANCIAL INSTITUTIONS - CONTINUED

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.

At September 30, 2008, 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, 2008 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.

CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

SEPTEMBER 30, 2008 AND 2007

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.

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	\$ 300,788,754
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. Liberty Mutual Insurance Company 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.

Energy Tip On EnergyGuide labels, the SEER (Seasonal Energy Efficiency Ratio) measures efficiency during the cooling season and HSPF (Heating Season Performance Factor) measures efficiency during the heating season.

**CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS
NOTES TO THE FINANCIAL STATEMENTS - CONTINUED**

SEPTEMBER 30, 2008 AND 2007

NOTE 12 - UNPAID INSURANCE CLAIMS, CLAIMS PAID AND CLAIMS PAYMENTS

	Health 2008	Health 2007	Workers Comp-2008	Workers Comp-2007
Unpaid-beginning	\$ 329,000	\$ 310,000	\$ 173,270	\$ 169,808
Incurred costs	6,032,714	4,317,457	645,933	324,332
Amount paid	(5,570,713)	(4,298,457)	(591,342)	(320,870)
Unpaid-ending	\$ 591,001	\$ 329,000	\$ 227,861	\$ 173,270

NOTE 13 - 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, HU provides post-retirement Medical and nominal Life Insurance to all employees who retire from HU under the provisions of the qualified plan and a minimum of 20 years of service. As of October 1, 2007, approximately 216 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 HU 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 HU's 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 fiscal 2008 totaled \$1,913,794.

HU's 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 HU 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, 2008 with a 7% discount rate. The ARC for HU is \$1,913,794. The present value of the OPEB is \$33,233,911 with an actuarial accrued liability of \$25,774,602. While HU established an irrevocable trust to pay it's 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 0 as of 9/30/2008. Health care costs were trended at an initial rate of 10% with an ultimate rate of 5%. The ultimate rate trends to be reached in 2015.

Energy Tip Insulation in crawl spaces and walls is commonly overlooked. A contractor may be required to add insulation to walls. A layer or two of polyethylene film will reduce moisture migration into the crawl space.

CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

SEPTEMBER 30, 2008 AND 2007

NOTE 14 - UTILITY PLANT IN SERVICE

Electric System

	Balance October 1, 2006	Additions	Retirements	Balance September 30, 2007
Land and land rights	\$ 4,007,267	\$ 212,268	\$ -	\$ 4,219,535
Structures and improvements	315,540,825	20,056,516	(2,506,039)	333,091,302
Furniture, fixtures and other	16,621,711	2,219,387	(1,389,232)	17,451,866
Total	336,169,803	22,488,171	(3,895,271)	354,762,703
Less accumulated depreciation	(142,418,415)	(12,585,571)	3,907,690	(151,096,296)
Retirement in progress	3,891	-	-	3,891
Construction in progress	6,127,529	26,589,848	(23,298,504)	9,418,873
	\$ 199,882,808			\$ 213,089,171

	Balance October 1, 2007	Additions	Retirements	Balance September 30, 2008
Land and land rights	\$ 4,219,535	\$ 69,065	\$ -	\$ 4,288,600
Structures and improvements	333,091,302	18,865,268	(3,922,595)	348,033,974
Furniture, fixtures and other	17,451,866	1,541,787	(418,635)	18,575,018
Total	354,762,703	20,476,120	(4,341,231)	370,897,592
Less accumulated depreciation	(151,096,296)	(12,655,708)	3,137,876	(160,614,128)
Retirement in progress	3,891	-	-	3,891
Construction in progress	9,418,873	26,301,381	(20,961,020)	14,759,234
	\$213,089,171			\$ 225,046,589

Energy Tip Sources of air leaks in homes include dropped ceilings, recessed lighting, attic entrances, water and furnace flues, door frames, chimney flashing, electrical outlets and switches, and window frames.

**CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS
NOTES TO THE FINANCIAL STATEMENTS - CONTINUED**

SEPTEMBER 30, 2008 AND 2007

NOTE 14 - UTILITY PLANT IN SERVICE

Natural Gas System

	Balance October 1, 2006	Additions	Retirements	Balance September 30, 2007
Land and land rights	\$ 383,735	\$ 50,000	\$ -	\$ 433,735
Structures and improvements	99,116,471	4,570,432	(157,865)	103,529,038
Furniture, equipment and other	6,699,568	937,956	(495,149)	7,142,375
Total	106,199,774	5,558,388	(653,014)	111,105,148
Less accumulated depreciation	(33,145,395)	(2,781,113)	653,014	(35,273,494)
Construction in progress	1,497,857	5,084,076	(4,997,368)	1,584,565
	\$ 74,552,236			\$ 77,416,219

	Balance October 1, 2007	Additions	Retirements	Balance September 30, 2008
Land and land rights	\$ 433,735	\$ 37,500	\$ -	\$ 471,235
Structures and improvements	103,529,038	5,639,114	(79,496)	109,088,656
Furniture, equipment and other	7,142,375	435,886	(119,724)	7,458,537
Total	111,105,148	6,112,500	(199,221)	117,018,428
Less accumulated depreciation	(35,273,494)	(2,879,604)	166,712	(37,986,386)
Construction in progress	1,584,565	4,956,884	(5,100,535)	1,440,914
	\$ 77,416,219			\$ 80,472,956

Energy Tip Are your natural gas appliances burning efficiently? Blue flames indicate the correct burn rate. Yellow flames mean the gas is burning inefficiently. Consult the manufacturer about the proper adjustment.

CITY OF HUNTSVILLE ELECTRIC, NATURAL GAS AND WATER SYSTEMS

NOTES TO THE FINANCIAL STATEMENTS - CONTINUED

SEPTEMBER 30, 2008 AND 2007

NOTE 14 - UTILITY PLANT IN SERVICE

Water System

	Balance October 1, 2006	Additions	Retirements	Balance September 30, 2007
Land and land rights	\$ 4,007,267	\$ 212,268	\$ -	\$ 4,219,535
Land and land rights	\$ 1,748,064	\$ -	\$ -	\$ 1,748,064
Structures and improvements	185,320,948	7,224,567	(180,198)	192,365,317
Furniture, equipment and other	4,508,749	984,208	(257,627)	5,235,330
Total	191,577,761	8,208,775	(437,825)	199,348,711
Less accumulated depreciation	(70,695,238)	(4,506,201)	425,406	(74,776,033)
Construction in progress	5,916,783	8,618,602	(4,568,668)	9,966,717
	\$ 126,799,306			\$ 134,539,395

	Balance October 1, 2007	Additions	Retirements	Balance September 30, 2008
Land and land rights	\$ 1,748,064	\$ 27,400	\$ -	\$ 1,775,464
Structures and improvements	192,365,317	19,516,431	(634,129)	211,247,619
Furniture, equipment and other	5,235,330	465,672	(323,758)	5,377,244
Total	199,348,711	20,009,503	(957,888)	218,400,326
Less accumulated depreciation	(74,776,033)	(4,657,625)	870,271	(78,563,387)
Construction in progress	9,966,717	12,241,748	(14,429,884)	7,778,581
	\$ 134,539,395			\$ 147,615,520



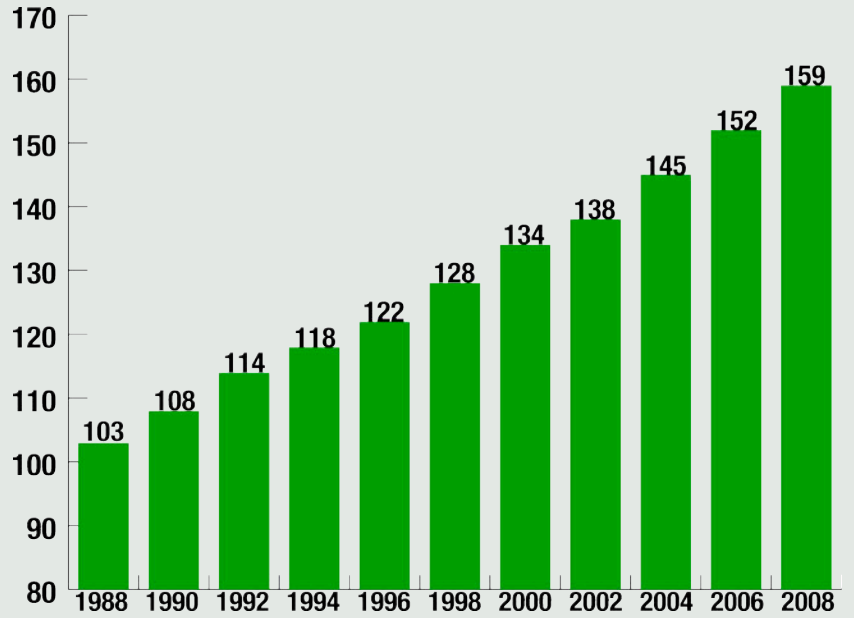
Keep burners and reflectors on your stovetop clean. They will reflect the heat better, and you will save energy.



Electric

Customer Growth

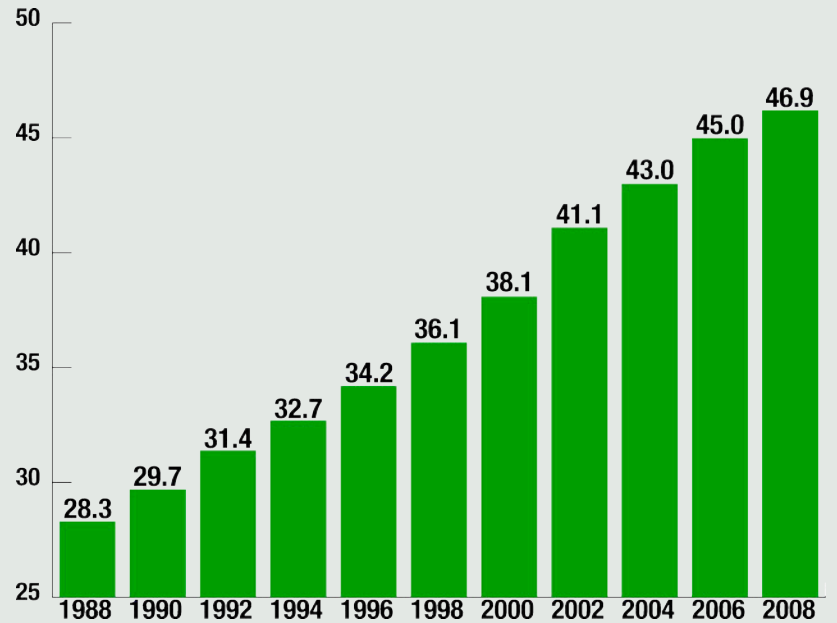
Fiscal Years 1988-2008,
Two-Year Increments,
In Thousands



Natural Gas

Customer Growth

Fiscal Years 1988-2008,
Two-Year Increments,
In Thousands



Water

Customer Growth

Fiscal Years 1988-2008,
Two-Year Increments,
In Thousands

