

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

**COMPONENT UNIT  
FINANCIAL STATEMENTS**

**SEPTEMBER 30, 2010 AND 2009**

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## **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)

	<b>FY 2010</b>	<b>Restated FY 2009</b>	<b>\$ Change</b>
Current and Other Assets	\$ 124,341	\$ 112,798	\$ 11,543
Capital Assets (Net)	248,036	241,695	6,340
<b>Total Assets</b>	<b>\$ 372,377</b>	<b>\$ 354,493</b>	<b>\$ 17,883</b>
Current and Other Liabilities	\$ 132,278	\$ 83,467	\$ 48,811
Long-Term Liabilities	19,207	48,942	(29,735)
<b>Total Liabilities</b>	<b>\$151,485</b>	<b>\$ 132,409</b>	<b>\$ 19,076</b>
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)
<b>Total Net Assets</b>	<b>\$220,892</b>	<b>\$ 222,085</b>	<b>\$ (1,193)</b>
<b>Total Liabilities and Net Assets</b>	<b>\$ 372,377</b>	<b>\$ 354,494</b>	<b>\$ 17,883</b>

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)**

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

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)**

	<b>FY2010</b>	<b>FY2009</b>	<b>\$ Change</b>
Current and Other Assets	\$46,132	\$43,871	\$2,261
Capital Assets (Net)	93,502	84,924	8,578
<b>Total Assets</b>	<b>\$139,634</b>	<b>\$128,795</b>	<b>\$10,839</b>
Long-Term Debt Outstanding	\$8,520	\$8,975	(\$455)
Other Liabilities	14,059	12,767	1,292
<b>Total Liabilities</b>	<b>\$22,579</b>	<b>\$21,742</b>	<b>\$837</b>
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)
<b>Total Net Assets</b>	<b>\$117,055</b>	<b>\$107,053</b>	<b>\$10,002</b>
<b>Total Liabilities and Net Assets</b>	<b>\$139,634</b>	<b>\$128,795</b>	<b>\$10,839</b>

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)**

	<b>FY2010</b>	<b>FY2009</b>	<b>\$ Change</b>
Operating Revenues	\$63,025	\$63,412	(\$387)
Non-Operating Revenues	159	655	(496)
<b>Total Revenues</b>	<b>\$63,184</b>	<b>\$64,067</b>	<b>(\$883)</b>
Depreciation Expense	\$2,926	\$2,548	\$378
Operating Expense	46,471	53,183	(6,712)
Non-Operating Expense	552	477	75
<b>Total Expenses</b>	<b>\$49,949</b>	<b>\$56,208</b>	<b>(\$6,259)</b>
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
<b>Change in Net Assets</b>	<b>\$10,003</b>	<b>\$4,727</b>	<b>\$5,276</b>
Beginning Net Assets	\$107,053	\$102,326	\$4,727
<b>Ending Net Assets</b>	<b>\$117,056</b>	<b>\$107,053</b>	<b>\$10,003</b>

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)**

	<b>FY2010</b>	<b>FY2009</b>	<b>\$ Change</b>
Current and Other Assets	\$38,450	\$33,097	\$5,353
Capital Assets (Net)	161,783	163,873	(2,090)
<b>Total Assets</b>	<b>\$200,233</b>	<b>\$196,970</b>	<b>\$3,263</b>
Long-Term Debt Outstanding	\$38,785	\$40,905	(\$2,120)
Other Liabilities	11,266	12,750	(1,484)
<b>Total Liabilities</b>	<b>\$50,051</b>	<b>\$53,655</b>	<b>(\$3,604)</b>
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
<b>Total Net Assets</b>	<b>\$150,182</b>	<b>\$143,315</b>	<b>\$6,867</b>
<b>Total Liabilities and Net Assets</b>	<b>\$200,233</b>	<b>\$196,970</b>	<b>\$3,263</b>

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**

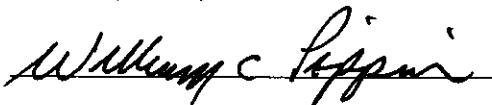
(000's)

	<b>FY2010</b>	<b>FY2009</b>	<b>\$ Change</b>
Operating Revenues	\$25,328	\$25,131	\$197
Non-Operating Revenues	71	78	(7)
<b>Total Revenues</b>	<b>\$25,399</b>	<b>\$25,209</b>	<b>\$190</b>
Depreciation Expense	\$5,616	\$4,847	\$769
Operating Expense	15,941	15,566	375
Non-Operating Expense	(415)	1,035	(1,450)
<b>Total Expenses</b>	<b>\$21,142</b>	<b>\$21,448</b>	<b>(\$306)</b>
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
<b>Change in Net Assets</b>	<b>\$6,866</b>	<b>\$7,122</b>	<b>(\$256)</b>
Beginning Net Assets	\$143,316	\$136,194	\$7,122
<b>Ending Net Assets</b>	<b>\$150,182</b>	<b>\$143,316</b>	<b>\$6,866</b>

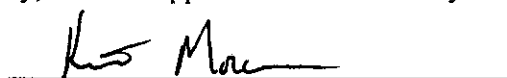
Gallons sold increased by 169 million gallons which was a 1.5% increase in total volume of sales from the previous year. Sales revenues increased by .08%.

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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## 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>
<b>Current Assets</b>		
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
<b>Total Current Assets</b>	<u>97,416,088</u>	<u>80,604,581</u>
 <b>Restricted and Board Designated Assets (Note 1)</b>		
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
<b>Total Restricted Assets and Designated Assets</b>	<u>26,280,002</u>	<u>31,342,729</u>
 <b>Deferred Charges</b>		
Unamortized bond expense (Note 5)	644,846	722,592
Other deferred charges	0	128,100
<b>Total Deferred Charges</b>	<u>644,846</u>	<u>850,692</u>
 <b>Utility Plant (Note 1)</b>		
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)
<b>Total Utility Plant</b>	<u>248,035,601</u>	<u>241,695,195</u>
 <b>TOTAL ASSETS</b>	 <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>
<b>Current Liabilities</b>		
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
<b>Total Current Liabilities</b>	<u>130,534,716</u>	<u>81,540,094</u>
 <b>Liabilities Payable from Restricted Assets</b>		
Current maturities of long-term debt (Note 5)	1,455,000	1,615,000
Interest payable	288,245	311,158
<b>Total Liabilities Payable from Restricted Assets</b>	<u>1,743,245</u>	<u>1,926,158</u>
 <b>Long-Term Debt (Note 5)</b>		
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)
<b>Total Long-Term Debt</b>	<u>19,206,651</u>	<u>48,942,283</u>
<b>Total Liabilities</b>	<u>151,484,612</u>	<u>132,408,535</u>
 <b>Net Assets</b>		
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)
<b>Total Net Assets</b>	<u>220,891,925</u>	<u>222,084,662</u>
<b>TOTAL NET ASSETS AND LIABILITIES</b>	<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
<b>Operating Revenue</b>		
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
<b>Total Operating Revenue</b>	456,705,350	451,206,677
<b>Operating Expenses</b>		
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
<b>Total Operating Expenses</b>	444,698,579	437,530,758
<b>Operating Income</b>	12,006,771	13,675,919
<b>Other Revenue and (Expenses)</b>		
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
<b>Total Other Revenue (Expenses)</b>	(1,435,710)	(2,096,614)
<b>Change in Net Assets before Transfers</b>	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>
<b>CASH FLOWS FROM (USED FOR) OPERATING ACTIVITIES</b>		
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>
<b>CASH FLOWS FROM (USED FOR) NONCAPITAL FINANCING ACTIVITIES</b>		
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>
<b>CASH FLOWS FROM (USED FOR) INVESTING ACTIVITIES</b>		
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>
<b>CASH FLOWS FROM (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
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>
<b>INCREASE (DECREASE) IN CASH</b>	3,921,950	(2,371,021)
<b>CASH AT BEGINNING OF YEAR</b>	<u>48,029,835</u>	<u>50,400,856</u>
<b>CASH AT END OF YEAR</b>	<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>
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH</b>		
<b>    FLOWS FROM OPERATING ACTIVITIES</b>		
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>
<b>NET CASH FLOWS FROM OPERATING ACTIVITIES</b>	<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>
<b>Current Assets</b>		
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
<b>Total Current Assets</b>	<u>29,648,066</u>	<u>26,968,847</u>
 <b>Restricted Assets and Board Designated Assets</b>		
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
<b>Restricted Assets and Designated Assets</b>	<u>16,305,102</u>	<u>16,710,615</u>
 <b>Other Assets</b>		
Unamortized debt expense	<u>179,296</u>	<u>191,383</u>
 <b>Utility Plant (Note 1)</b>		
Plant in service	135,833,172	124,502,336
Construction in progress	1,378,594	993,341
	<u>137,211,766</u>	<u>125,495,677</u>
Less: Accumulated depreciation	<u>(43,710,202)</u>	<u>(40,571,604)</u>
<b>Total Utility Plant</b>	<u>93,501,564</u>	<u>84,924,073</u>
 <b>TOTAL ASSETS</b>	 <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**

	2010	2009
<b>Current Liabilities</b>		
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
<b>Total Current Liabilities</b>	13,543,135	12,264,791
 <b>Liabilities Payable from Restricted Assets</b>		
Current maturities of revenue bonds	455,000	440,000
Interest payable	60,403	62,786
<b>Total Liabilities Payable from Restricted Assets</b>	515,403	502,786
 <b>Long-Term Debt</b>		
Revenue bonds - less current maturity	8,520,000	8,975,000
 <b>Total Liabilities</b>	22,578,538	21,742,577
 <b>Net Assets</b>		
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
<b>Total Net Assets</b>	117,055,490	107,052,341
 <b>TOTAL NET ASSETS AND LIABILITIES</b>	\$ 139,634,028	\$ 128,794,918

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>
<b>Operating Revenue</b>		
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
<b>Total Operating Revenue</b>	<u>63,025,163</u>	<u>63,412,119</u>
<b>Operating Expenses</b>		
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
<b>Total Operating Expenses</b>	<u>49,396,644</u>	<u>55,731,251</u>
<b>Operating Income</b>	<u>13,628,519</u>	<u>7,680,868</u>
<b>Other Revenue and (Expenses)</b>		
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)
<b>Total Other Revenue (Expenses)</b>	<u>(392,996)</u>	<u>177,852</u>
<b>Change in Net Assets Before Capital Contributions And Transfers</b>	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>
<b>Change in Net Assets</b>	10,003,149	4,726,536
<b>Beginning Net Assets</b>	<u>107,052,341</u>	<u>102,325,805</u>
<b>Ending Net Assets</b>	<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>
<b>CASH FLOWS FROM (USED FOR) OPERATING ACTIVITIES</b>		
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>
<b>CASH FLOWS FROM (USED FOR) NONCAPITAL FINANCING ACTIVITIES</b>		
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>
<b>CASH FLOWS FROM (USED FOR) INVESTING ACTIVITIES</b>		
Interest income earned on investments	158,659	655,143
Net cash from (used for) investing activities	<u>158,659</u>	<u>655,143</u>
<b>CASH FLOWS FROM (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
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>
<b>INCREASE (DECREASE) IN CASH</b>	6,028,343	(4,770,560)
<b>CASH AT BEGINNING OF YEAR</b>	<u>14,878,268</u>	<u>19,648,828</u>
<b>CASH AT END OF YEAR</b>	<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>
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH FLOWS FROM OPERATING ACTIVITIES</b>		
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>
<b>NET CASH FLOWS FROM OPERATING ACTIVITIES</b>	<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**

	<u>2010</u>	<u>2009</u>
<b>Current Assets</b>		
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
<b>Total Current Assets</b>	<u>17,669,616</u>	<u>6,526,350</u>
<b>Restricted Assets and Board Designated Assets</b>		
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
<b>Total Restricted Assets and Board Designated Assets</b>	<u>19,759,435</u>	<u>25,505,547</u>
<b>Deferred Charges</b>		
Unamortized bond expense (Note 5)	1,021,387	1,065,635
Other deferred charges	0	0
<b>Total Deferred Charges</b>	<u>1,021,387</u>	<u>1,065,635</u>
<b>Utility Plant (Note 1)</b>		
Plant in service	241,405,262	244,335,430
Construction in progress	8,450,165	2,782,912
	<u>249,855,427</u>	<u>247,118,342</u>
Less: Accumulated depreciation	(88,072,751)	(83,245,133)
<b>Total Utility Plant</b>	<u>161,782,676</u>	<u>163,873,209</u>
<b>TOTAL ASSETS</b>	<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 NET ASSETS  
SEPTEMBER 30, 2010 AND 2009**

**LIABILITIES AND NET ASSETS**

	<u>2010</u>	<u>2009</u>
<b>Current Liabilities</b>		
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
<b>Total Current Liabilities</b>	<u>7,438,367</u>	<u>8,890,186</u>
 <b>Liabilities Payable from Restricted Assets</b>		
Current maturities of long-term debt (Note 5)	2,120,000	2,055,000
Interest payable	747,638	775,466
<b>Total Liabilities Payable from Restricted Assets</b>	<u>2,867,638</u>	<u>2,830,466</u>
 <b>Long-Term Debt (Note 5)</b>		
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)
<b>Total Long-Term Debt</b>	<u>39,744,930</u>	<u>41,934,646</u>
 <b>Total Liabilities</b>	<u>50,050,935</u>	<u>53,655,298</u>
 <b>Net Assets</b>		
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
<b>Total Net Assets</b>	<u>150,182,179</u>	<u>143,315,443</u>
 <b>TOTAL NET ASSETS AND LIABILITIES</b>	<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>
<b>Operating Revenue</b>		
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
<b>Total Operating Revenue</b>	<u>25,328,027</u>	<u>25,130,734</u>
 <b>Operating Expenses</b>		
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
<b>Total Operating Expenses</b>	<u>21,556,817</u>	<u>20,412,711</u>
 <b>Operating Income</b>	<u>3,771,210</u>	<u>4,718,023</u>
 <b>Other Revenue and (Expenses)</b>		
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)
<b>Total Other Revenue (Expenses)</b>	<u>486,215</u>	<u>(957,007)</u>
 <b>Change in Net Assets before Capital Contributions and Transfers</b>	 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>
<b>CASH FLOWS FROM (USED FOR) OPERATING ACTIVITIES</b>		
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>
<b>CASH FLOWS FROM (USED FOR) NONCAPITAL FINANCING ACTIVITIES</b>		
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>
<b>CASH FLOWS FROM (USED FOR) INVESTING ACTIVITIES</b>		
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>
<b>CASH FLOWS FROM (USED FOR) CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
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>
<b>INCREASE (DECREASE) IN CASH</b>	11,572,139	(3,622,920)
<b>CASH AT BEGINNING OF YEAR</b>	<u>3,276,655</u>	<u>6,899,575</u>
<b>CASH AT END OF YEAR</b>	<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>
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH FLOWS FROM OPERATING ACTIVITIES</b>		
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>
<b>NET CASH FLOWS FROM OPERATING ACTIVITIES</b>	<u>\$ 8,424,618</u>	<u>\$ 10,776,839</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.