

Making Changes for the Future

**Huntsville Utilities
2011 Annual Report**

FINANCIAL STATEMENTS

(Component Unit)

September 30, 2011 & 2010



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City of Huntsville Electric, Natural Gas, and Water Systems

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City of Huntsville Electric, Natural Gas, and Water Systems *Independent Auditor's Report on Financial Statements*



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INDEPENDENT AUDITORS' REPORT ON FINANCIAL STATEMENTS

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

We have audited the accompanying financial statements of net assets of the City of Huntsville Electric, Natural Gas, and Water Systems (the Utilities), component units of the City of Huntsville, Alabama, as of September 30, 2011, and the related statements of revenue, expense 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 opinions on these financial statements based on our audit. The September 30, 2010 financial statements were examined by other auditors whose report dated March 28, 2011 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 and the standards applicable to financial audits contained in **Government Auditing Standards**, issued by the Comptroller General of the United States. 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, 2011, 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.

City of Huntsville Electric, Natural Gas, and Water Systems

Independent Auditor's Report on Financial Statements

In accordance with **Government Auditing Standards**, we have also issued our report dated February 1, 2012 on our consideration of the Utilities internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with **Government Auditing Standards** and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and schedule of funding progress information on pages 27 through 33 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, **Audits of States, Local Governments, and Non-Profit Organizations**, and is not a required part of the financial statements. The schedule of expenditures of federal awards is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Carr, Riggs & Ingram, L.L.C.

CARR, RIGGS & INGRAM, L.L.C.
Certified Public Accountants
February 1, 2012

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City of Huntsville Electric, Natural Gas, and Water Systems *Management Discussion & Analysis*

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 Sheets 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. These 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, Natural Gas, and Water Systems

Electric Service

Table A-1
Condensed Balance Sheet (000's)

	2011	2010	\$ Change
Assets			
Current and other assets	\$ 79,707	\$ 124,341	\$ (44,634)
Capital assets (net)	249,070	248,036	1,034
Total assets	\$ 328,777	\$ 372,377	\$ (43,600)
Liabilities			
Current and other liabilities	\$ 46,893	\$ 98,700	\$ (51,807)
Long-term liabilities	50,705	53,004	(2,299)
Total liabilities	97,598	151,704	(54,106)
Net Assets			
Invested in capital assets, net of related debt	232,776	227,731	5,045
Restricted assets	4,776	6,918	(2,142)
Unrestricted assets	(6,373)	(13,976)	7,603
Total net assets	231,179	220,673	10,506
Total liabilities and net assets	\$ 328,777	\$ 372,377	\$ (43,600)

The old IBM legacy Billing and CIS System was replaced by SAP software during FY 2011. 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 \$10.9 million. The replaced Billing and CIS system was a 30 year-old legacy system whose language and operating system was no longer supported.

The Electric System available cash position has decreased due to payments made to TVA in the amount of \$37.6 million for unbilled contract amounts the years 2004 to 2011. The adjustments increase the cost of power for each of the years. The adjustment made to 2011 power cost was \$2.4 Million. Power costs were increased by \$7,028,898 for the year ending 2010, 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, Natural Gas, and Water Systems

Electric Service

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

	2011	2010	\$ Change
Operating revenues	\$ 493,393	\$ 462,638	\$ 30,755
Non-operating revenues	370	437	(67)
Total revenues	493,763	463,075	30,688
Operating expense	454,686	435,449	19,237
Depreciation expense	15,202	14,528	674
Non-operating expense	1,261	1,873	(612)
Total expenses	471,149	451,850	19,299
Income before transfers	22,614	11,225	11,389
Transfers out – tax equivalents	(12,108)	(11,764)	(344)
Change in net assets	10,506	(539)	11,045
Beginning net assets	220,673	221,212	(539)
Ending net assets	\$ 231,179	\$ 220,673	\$ 10,506

The change in operating revenues was an increase of \$30.7 million (+6.6%) due to the increase in TVA's wholesale quarterly fuel cost adjustments (FCA's). Kilowatt hour sales decreased by 5.3%. The System experienced a colder than normal winter period. Extreme summer temperatures were higher than FY2010. Our customer growth for the area increased to 4.3% this year with the end 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. 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 \$67 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 \$19.3 million, \$11.5 million of which was for wholesale power from TVA. The average cost of kWh purchased increased from 6.59 cents (\$0.0659) in FY2010 to 7.45 cents (\$0.0745) in FY 2010. Purchases of kWh decreased by 7.4%. Operation and Maintenance expense increased \$6.6 million due to storm damage that occurred in the area. Depreciation Expense increased \$674 thousand due to capital projects being completed and placed in service.

The Electric System was notified of unbilled contract payments by TVA for the years 2004 to 2011. The adjustments increase the cost of power for each of the years. Power costs were increased by \$2,371,156 and \$7,028,898 for the years ending 2011 and 2010, which reduced net income for the years by the same amount.

City of Huntsville Electric, Natural Gas, and Water Systems

Natural Gas Service

Table B-1
Condensed Balance Sheet (000's)

	2011	2010	\$ Change
Assets			
Current and other assets	\$ 49,997	\$ 46,132	\$ 3,865
Capital assets (net)	96,726	93,502	3,224
Total assets	\$ 146,723	\$ 139,634	\$ 7,089
Liabilities			
Long-term debt outstanding	\$ 16,282	\$ 16,714	\$ (432)
Other liabilities	5,501	5,750	(249)
Total liabilities	21,783	22,464	(681)
Invested in capital assets, net of related debt	88,315	84,645	3,670
Restricted	954	13,212	(12,258)
Unrestricted	35,671	19,313	16,358
Total net assets	124,940	117,170	7,770
Total liabilities and net assets	\$ 146,723	\$ 139,634	\$ 7,089

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 \$3.9 million while at the same time Other Liabilities show a decrease of \$249 thousand. Invested in Capital Assets, Net of Related Debt increased \$3 million as we generated a net income of \$7.6 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, 2011 available funds, including reserves, stood at \$40.9 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 Gas System currently has adequate reserves to meet its future Operating and Capital requirements.

City of Huntsville Electric, Natural Gas, and Water Systems

Natural Gas Service

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

	2011	2010	\$ Change
Operating revenues	\$ 50,921	\$ 63,025	\$ (12,104)
Non-operating revenues	199	159	40
Total revenues	51,120	63,184	(12,064)
Depreciation expense	3,217	2,926	291
Operating expense	37,599	46,104	(8,505)
Non-operating expense	443	552	(109)
Total expenses	41,259	49,582	(8,323)
Income (loss) before contributions and transfers	9,861	13,602	(3,741)
Capital contributions	793	325	468
Transfers out - tax equivalents	(2,884)	(3,557)	673
Change in net assets	7,770	10,370	(2,600)
Beginning net assets	117,170	106,800	10,370
Ending net assets	\$ 124,940	\$ 117,170	\$ 7,770

Operating revenues decreased by \$12.1 million reflecting a 15.7% rate reduction and a 6.3% decrease in MCF sold.

Operating Expense decreased by \$8.3 million. The price of natural gas delivered was \$6.68 an MCF compared to \$8.10 for 2010. This decrease in Purchased Gas accounted for \$8.5 million of the Operating Expense decrease.

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 Electric, Natural Gas, and Water Systems

Water Works

Table C-1
Condensed Balance Sheet (000's)

	2011	2010	\$ Change
Assets			
Current and other assets	\$ 40,147	\$ 38,450	\$ 1,697
Capital assets (net)	164,545	161,783	2,762
Total assets	\$ 204,692	\$ 200,233	\$ 4,459
Liabilities			
Long-term debt outstanding	\$ 40,944	\$ 43,854	\$ (2,910)
Other liabilities	11,120	6,276	4,844
Total liabilities	52,064	50,130	1,934
Invested in capital assets net of related debt	125,043	120,191	4,852
Restricted	12,179	13,635	(1,456)
Unrestricted	15,406	16,277	(871)
Total net assets	152,628	150,103	2,525
Total liabilities and net assets	\$ 204,692	\$ 200,233	\$ 4,459

Current and Other Assets increased by \$1.7 million. This was due to an increase in Cash and Cash Equivalents of \$2.1 million. Our Capital Assets, Net of Related Debt increased \$4.8 million due to increases in Net Capital Assets of \$2.8 million and decrease in Long-Term Debt of \$2.9 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 Electric, Natural Gas, and Water Systems

Water Works

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

	2011	2010	\$ Change
Operating revenues	\$ 26,277	\$ 25,328	\$ 949
Non-operating revenues	111	1,702	(1,591)
Total revenues	26,388	27,030	(642)
Depreciation expense	5,680	5,616	64
Operating expense	17,195	15,649	1,546
Non-operating expense	1,818	1,216	602
Total expenses	24,693	22,481	2,212
Income (loss) before contributions and transfers	1,695	4,549	(2,854)
Capital contributions	2,228	3,947	(1,719)
Transfers out - tax equivalents	(1,398)	(1,338)	(60)
Change in net assets	2,525	7,158	(4,633)
Beginning net assets	150,103	142,945	7,158
Ending net assets	\$ 152,628	\$ 150,103	\$ 2,525

Gallons sold increased by 362 million gallons which was a 3.1% increase in total volume of sales from the previous year. Sales revenues increased by 3.08%.

Operating Expense increased by \$1.5 million. Most of this increase was in Maintenance of the Distribution System.

Capital Contributions decreased this year by \$1.7 million as the area construction cooled somewhat with the general economy.

William Pippin, Chief Executive Officer

Keith Moran, Controller

City of Huntsville Electric, Natural Gas, and Water Systems

Electric System

Statement of Net Assets

<i>As of September 30,</i>	2011	2010 (Restated)
Assets		
Current assets		
Cash and cash equivalents	\$ 11,413,175	\$ 48,280,031
Investments	-	3,671,754
Accounts receivable - trade, net of allowance for doubtful accounts of \$301,450 in 2011 and \$301,450 in 2010	43,276,640	36,707,444
Inventories	6,196,458	5,711,435
Prepaid expenses	43,063	14,586
Accrued interest, rent and other receivables	3,971,486	3,030,838
Total current assets	64,900,822	97,416,088
Board designated and restricted assets		
Cash, cash equivalents, and investments		
Designated		
Emergency funds	-	3,000,000
Insurance funds	1,295,631	1,253,398
Construction funds	6,184,772	11,726,914
Renewal and replacement funds	-	3,109,364
Worker's compensation funds	2,000,000	2,139,489
Restricted		
Improvement bond funds	500,000	500,000
Debt service bond funds	1,415,912	1,573,718
Reserve debt service bond funds	2,705,428	2,705,428
Other special funds	155,426	271,691
Total board designated and restricted assets	14,257,169	26,280,002
Other assets		
Unamortized bond expense	548,837	644,846
Utility Plant		
Plant in service	431,493,298	423,392,848
Construction in progress	16,794,368	9,975,346
	448,287,666	433,368,194
Less: accumulated depreciation	(199,217,862)	(185,332,593)
Total utility plant	249,069,804	248,035,601
Total assets	\$ 328,776,632	\$ 372,376,537

-Continued-

City of Huntsville Electric, Natural Gas, and Water Systems

Electric System

Statement of Net Assets (Continued)

<i>As of September 30,</i>	2011	2010 (Restated)
Liabilities and Net Assets		
Current liabilities		
Accounts payable - trade	\$ 34,603,078	\$ 43,719,627
Accounts payable - other utility departments	1,839,480	7,451,361
Customer meter deposits, including accrued interest of \$1,078,110 in 2011 and \$1,108,832 in 2010	3,884,204	3,755,255
TVA contract payable	-	35,272,375
Accrued payroll and compensated absences	4,114,240	3,864,495
Other current liabilities	850,453	2,893,202
Total current liabilities	45,291,455	96,956,315
Liabilities payable from restricted assets		
Current maturities of long-term debt	1,365,000	1,455,000
Interest payable	236,282	288,245
Total liabilities payable from restricted assets	1,601,282	1,743,245
Long-term debt		
Customer meter deposits, less current portion, including accrued interest of \$9,702,986 in 2011 and \$9,979,492 in 2010	34,957,837	33,797,300
Revenue bonds, less current portion	15,700,000	19,165,000
Unamortized bond premium	160,363	191,019
Less: Unamortized debt retirement	(113,530)	(149,368)
Total long-term debt	50,704,670	53,003,951
Total liabilities	97,597,407	151,703,511
Net assets		
Invested in capital assets, net of related debt	232,775,830	227,730,550
Restricted	4,776,765	6,918,634
Unrestricted	(6,373,370)	(13,976,158)
Total net assets	231,179,225	220,673,026
Total net assets and liabilities	\$ 328,776,632	\$ 372,376,537

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

City of Huntsville Electric, Natural Gas, and Water Systems

Electric System

Statement of Revenues, Expenses, and Changes in Net Assets

<i>For the years ended September 30,</i>	2011	2010 (Restated)
Operating Revenues		
Residential	\$ 235,162,306	\$ 223,326,418
Large commercial and industrial	199,782,931	183,483,896
Small commercial	33,639,451	34,441,944
Public street and highway lighting	4,360,255	4,098,340
Other operating revenue	20,447,758	17,287,642
Total operating revenues	493,392,701	462,638,240
Operating Expenses		
Purchased power	409,517,752	398,058,964
Transmission	594,038	209,092
Distribution	28,427,416	21,860,305
Customer accounting	4,977,162	4,153,133
Administrative and general	9,832,595	9,940,122
Depreciation	15,202,443	14,528,405
Payroll taxes	1,337,176	1,227,024
Total operating expenses	469,888,582	449,977,045
Operating Income	23,504,119	12,661,195
Non-operating Revenues (Expenses)		
Interest income	370,382	437,243
Interest expense	(1,188,407)	(1,740,099)
Amortization of bond discount	(96,009)	(205,846)
Amortization of bond premium	23,390	72,992
Total nonoperating revenues (expenses)	(890,644)	(1,435,710)
Income before Transfers	22,613,475	11,225,485
Transfers out - tax equivalent	(12,107,276)	(11,763,798)
Change in net assets	10,506,199	(538,313)
Net Assets - beginning of year, as previously reported	220,673,026	222,084,662
Prior period adjustment (Note 17)	-	(873,323)
Net Assets -beginning of year, as restated	220,673,026	221,211,339
Net Assets - ending	\$ 231,179,225	\$ 220,673,026

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

City of Huntsville Electric, Natural Gas, and Water Systems

Electric System

Statement of Cash Flows

<i>For the years ended September 30,</i>	2011	2010 (Restated)
Operating Activities		
Received from customers	\$ 486,823,505	\$ 450,566,839
Paid to suppliers for goods and services	(487,057,374)	(398,004,190)
Paid to employees for salaries and wages	(19,558,665)	(18,130,048)
Net cash provided by (used for) operating activities	(19,792,534)	34,432,601
Noncapital Financing Activities		
Transfers out - tax equivalent	(12,107,276)	(11,763,798)
Capital and Related Financial Activities		
Payment of principal on long-term debt	(3,555,000)	(1,615,000)
Additions to plant in service	(16,236,646)	(20,868,811)
Changes in special funds, net	12,022,833	5,062,727
Interest paid	(1,240,370)	(1,763,012)
Net cash used for capital and related financing activities	(9,009,182)	(19,184,096)
Investing Activities		
Reclassification of investments from cash & cash equivalents	3,671,754	(3,671,754)
Interest income earned on investments	370,382	437,243
Net cash provided by (used for) investing activities	4,042,136	(3,234,511)
Net increase (decrease) in cash and cash equivalents	(36,866,856)	250,196
Cash and Cash Equivalents - beginning of year	48,280,031	48,029,835
Cash and Cash Equivalent - end of year	\$ 11,413,175	\$ 48,280,031
Reconciliation of Operating Income to Net Cash Provided by (Used for) Operating Activities		
Operating income	\$ 23,504,119	\$ 12,661,195
Adjustments to reconcile operating income to net cash provided by (used for) operating activities:		
Depreciation and amortization	15,231,014	14,564,243
Change in accounts receivable - customer	(6,569,196)	(12,071,401)
Change in accounts receivable - other	(940,648)	(613,286)
Change in inventories	(485,023)	(198,783)
Change in prepaid expenses	(28,477)	(6,087)
Change in accounts payable	(14,728,430)	9,442,127
Change in TVA contract payable	(35,272,375)	7,028,898
Change in customer deposits	1,289,486	2,097,932
Change in accrued expenses and other current liabilities	(1,793,004)	1,527,763
Total adjustments	(43,296,653)	21,771,406
Net cash provided by (used for) operating activities	\$ (19,792,534)	\$ 34,432,601

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

City of Huntsville Electric, Natural Gas, and Water Systems

Natural Gas System

Statement of Net Assets

<i>As of September 30,</i>	2011	2010 (Restated)
Assets		
Current assets		
Cash and cash equivalents	\$ 20,218,548	\$ 17,234,857
Investments	7,581,122	3,671,754
Accounts receivable - trade, net of allowance for doubtful accounts of \$54,594 in 2011 and \$54,594 in 2010	1,760,795	650,851
Inventories		
Gas	5,093,813	6,093,906
Materials and supplies	589,912	1,084,308
Prepaid expenses	458	735
Accrued interest, rent and other receivables	512,693	911,654
Total current assets	35,757,341	29,648,065
Board designated and restricted assets		
Cash, cash equivalents, and investments		
Designated		
Insurance fund	997,670	997,670
Construction funds	7,620,538	6,959,413
Renewal and replacement funds	-	2,754,489
Rate stabilization	2,500,000	2,500,000
Restricted		
Debt service funds	818,244	818,244
Bond sinking funds	136,100	136,269
Worker's compensation fund	2,000,000	2,139,017
Total Board designated and restricted assets	14,072,552	16,305,102
Other assets		
Unamortized debt expense	167,208	179,296
Utility Plant		
Plant in service	140,028,229	135,833,172
Construction in progress	3,857,581	1,378,594
	143,885,810	137,211,766
Less: accumulated depreciation	(47,160,131)	(43,710,202)
Total utility plant	96,725,679	93,501,564
Total assets	\$ 146,722,780	\$ 139,634,027

-Continued-

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

City of Huntsville Electric, Natural Gas, and Water Systems

Natural Gas System

Statement of Net Assets (Continued)

<i>As of September 30,</i>	2011	2010 (Restated)
Liabilities and Net Assets		
Current liabilities		
Accounts payable - trade	\$ 2,580,536	\$ 2,436,952
Customer meter deposits, including accrued interest of \$240,852 in 2011 and \$254,038 in 2010	914,641	910,457
Accrued payroll and compensated absences	1,281,341	1,308,775
Other current liabilities	196,555	578,410
Total current liabilities	4,973,073	5,234,594
Liabilities payable from restricted assets		
Current maturities of long-term debt	470,000	455,000
Interest payable	57,749	60,403
Total liabilities payable from restricted assets	527,749	515,403
Long-term debt		
Customer meter deposits, less current portion, including accrued interest of \$2,167,670 in 2011 and \$2,286,341 in 2010	8,231,774	8,194,114
Revenue bonds, less current portion	8,050,000	8,520,000
Total long-term debt	16,281,774	16,714,114
Total liabilities	21,782,596	22,464,111
Net assets		
Invested in capital assets, net of related debt	88,315,138	84,645,457
Restricted	954,344	13,211,572
Unrestricted	35,670,702	19,312,887
Total net assets	124,940,184	117,169,916
Total net assets and liabilities	\$ 146,722,780	\$ 139,634,027

City of Huntsville Electric, Natural Gas, and Water Systems

Natural Gas System

Statement of Revenues, Expenses, and Changes in Net Assets

<i>For the years ended September 30,</i>	2011	2010 (Restated)
Operating Revenues		
Residential	\$ 21,097,052	\$ 27,097,128
Commercial	23,566,237	29,123,133
Industrial	2,763,176	3,407,307
Other operating revenue	3,494,272	3,397,595
Total operating revenues	50,920,737	63,025,163
Operating Expenses		
Purchased gas	30,019,464	38,574,435
Distribution	3,483,625	3,615,385
Customer accounting	881,401	796,967
Administrative and general	2,842,910	2,772,163
Depreciation	3,216,862	2,925,642
Payroll taxes	372,059	345,642
Total operating expenses	40,816,321	49,030,234
Operating Income	10,104,416	13,994,929
Non-operating Revenues (Expenses)		
Interest income	199,434	158,659
Interest expense	(430,883)	(539,568)
Amortization of debt discount	(12,087)	(12,087)
Total non-operating revenue (expenses)	(243,536)	(392,996)
Income Before Capital Contributions and Transfers	9,860,880	13,601,933
Capital contributions	793,252	325,499
Transfers out - tax equivalent	(2,883,864)	(3,557,873)
Change in net assets	7,770,268	10,369,559
Net Assets - beginning of year, as previously reported	117,169,916	107,052,341
Prior period adjustment (Note 17)	-	(251,984)
Net Assets - beginning of year, as restated	117,169,916	106,800,357
Net Assets - ending	\$ 124,940,184	\$ 117,169,916

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

City of Huntsville Electric, Natural Gas, and Water Systems

Natural Gas System

Statement of Cash Flows

<i>For the years ended September 30,</i>	2011	2010 (Restated)
Operating Activities		
Received from customers	\$ 49,810,793	\$ 63,443,778
Paid to suppliers for goods and services	(30,331,542)	(45,297,896)
Paid to employees for goods and services	(5,598,051)	(5,158,367)
Net cash provided by operating activities	13,881,200	12,987,515
Noncapital Financing Activities		
Transfers out - tax equivalent	(2,883,864)	(3,557,873)
Investing Activities		
Reclassification of investments from cash & cash equivalents	(3,909,368)	(3,671,754)
Interest income earned on investments	199,434	158,659
Net cash used for investing activities	(3,709,934)	(3,513,095)
Capital and Related Financing Activities		
Payment of principal on long-term debt	(455,000)	(440,000)
Additions to plant in service	(6,440,977)	(11,503,133)
Capital contributions	793,252	325,499
Changes in special funds, net	2,232,550	405,513
Interest expense	(433,536)	(541,951)
Net cash used for capital and related financing activities	(4,303,711)	(11,754,072)
Increase in cash and cash equivalents	2,983,691	(5,837,525)
Cash and Cash Equivalents - beginning of year	17,234,857	14,878,268
Cash and Cash Equivalents - end of year	\$ 20,218,548	\$ 9,040,743
Reconciliation of Operating Income to Net Cash Provided by (Used for) Operating Activities		
Operating income	\$ 10,104,416	\$ 13,994,929
Adjustments to reconcile operating income to net cash provided by (used for) operating activities:		
Depreciation and amortization	3,216,862	2,925,642
Change in accounts receivable - customer	(1,109,944)	418,615
Change in accounts receivable - other	398,961	383,294
Change in inventories	1,494,489	2,547,835
Change in prepaid expenses	277	(620)
Change in accounts payable	143,584	706,495
Change in customer deposits	41,844	(7,880,966)
Change in accrued expenses and other current liabilities	(409,289)	(107,709)
Total adjustments	3,776,784	(1,007,414)
Net cash provided by operating activities	\$ 13,881,200	\$ 12,987,515

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

City of Huntsville Electric, Natural Gas, and Water Systems

Water System

Statement of Net Assets

<i>As of September 30,</i>	2011	2010 (Restated)
Assets		
Current assets		
Cash and cash equivalents	\$ 6,451,052	\$ 11,177,040
Investments	2,418,878	3,671,754
Accounts receivable - trade, net of allowance for doubtful accounts of \$26,324 in 2011 and \$26,324 in 2010	6,397,579	1,202,812
Materials and supplies	1,552,008	1,616,140
Prepaid expenses	2,886	1,870
Total current assets	16,822,403	17,669,616
Board designated and restricted assets		
Cash, cash equivalents, and investments		
Designated		
Construction funds	5,680,272	5,124,762
Renewal and replacement funds	2,054,721	-
Insurance funds	1,000,000	1,000,000
Restricted		
Construction funds	6,186,388	6,186,388
Debt service bond funds	5,992,138	5,957,382
Worker's compensation funds	1,434,309	1,490,903
Total Board designated and restricted assets	22,347,828	19,759,435
Other assets		
Unamortized bond expense	977,139	1,021,387
Utility Plant		
Plant in service	249,192,828	241,405,262
Construction in progress	9,183,081	8,450,165
	258,375,909	249,855,427
Less: accumulated depreciation	(93,830,877)	(88,072,751)
Total utility plant	164,545,032	161,782,676
Total assets	\$ 204,692,402	\$ 200,233,114

-Continued-

City of Huntsville Electric, Natural Gas, and Water Systems

Water System

Statement of Net Assets (Continued)

<i>As of September 30,</i>	2011	2010 (Restated)
Liabilities and Net Assets		
Current liabilities		
Accounts payable - trade	\$ 1,360,037	\$ 755,005
Customer meter deposits, including accrued interest of \$101,233 in 2011 and \$136,381 in 2010	374,880	456,528
Accrued payroll and compensated absences	1,813,724	1,644,544
Other current liabilities	4,663,242	552,110
Total current liabilities	8,211,883	3,408,187
Liabilities payable from restricted assets		
Current maturities of long-term debt	2,190,000	2,120,000
Interest payable	718,929	747,638
Total liabilities payable from restricted assets	2,908,929	2,867,638
Long-term debt		
Customer meter deposits, less current portion, including accrued interest of \$911,094 in 2011 and \$1,227,426 in 2010	3,373,922	4,108,752
Revenue bonds, less current portion	36,595,000	38,785,000
Unamortized bond premium	1,165,665	1,210,854
Less: Unamortized bond retirement	(190,704)	(250,924)
Total long-term debt	40,943,883	43,853,682
Total liabilities	52,064,695	50,129,507
Net assets		
Invested in capital assets, net of related debt	125,043,280	120,191,495
Restricted	12,178,526	13,634,674
Unrestricted	15,405,901	16,277,438
Total net assets	152,627,707	150,103,607
Total net assets and liabilities	\$ 204,692,402	\$ 200,233,114

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

City of Huntsville Electric, Natural Gas, and Water Systems

Water System

Statement of Revenues, Expenses, and Changes in Net Assets

<i>For the years ended September 30,</i>	2011	2010 (Restated)
Operating Revenues		
Residential	\$ 13,181,878	\$ 12,618,223
Industrial	1,617,775	1,702,152
Commercial	6,839,290	6,506,573
Government	1,233,378	1,069,288
Fire hydrants	861,365	765,554
Other operating revenue	2,543,520	2,666,237
Total operating revenues	26,277,206	25,328,027
Operating Expenses		
Purification	1,383,879	1,212,275
Pumping	4,246,262	4,203,980
Distribution	4,871,372	3,935,841
Customer accounting	1,809,412	1,539,785
Administrative and general	4,318,988	4,174,390
Depreciation	5,679,915	5,616,132
Payroll taxes	564,644	582,832
Total operating expenses	22,874,472	21,265,235
Operating Income	3,402,734	4,062,792
Non-operating Revenues (Expenses)		
Interest income	111,172	70,717
Interest expense	(1,827,011)	(1,302,000)
Gain (loss) on sale of assets	-	1,631,810
Amortization of premium on debt	52,456	129,936
Amortization of bond discount	(44,248)	(44,248)
Total non-operating revenue (expenses)	(1,707,631)	486,215
Income before Capital Contributions and Transfers	1,695,103	4,549,007
Capital contributions	2,226,539	3,947,773
Transfers out - tax equivalent	(1,397,542)	(1,338,462)
Change in net assets	2,524,100	7,158,318
Net Assets - beginning of year, as previously reported	150,103,607	143,315,443
Prior period adjustment (Note 17)	-	(370,154)
Net Assets - beginning of year, as restated	150,103,607	142,945,289
Net Assets - ending	\$ 152,627,707	\$ 150,103,607

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

City of Huntsville Electric, Natural Gas, and Water Systems

Water System

Statement of Cash Flows

<i>For the years ended September 30,</i>	2011	2010 (Restated)
Operating Activities		
Received from customers	\$ 21,082,439	\$ 25,870,445
Paid to suppliers for goods and services	(4,829,512)	(9,495,303)
Paid to employees for services	(8,165,578)	(7,950,526)
Net cash provided by operating activities	8,087,349	8,424,616
Noncapital Financing Activities		
Transfers out - tax equivalents	(1,397,542)	(1,338,462)
Capital and Related Financing Activities		
Payment of principal on long-term debt	(2,120,000)	(2,055,000)
Proceeds from sale of Triana property	-	6,750,000
Additions to plant in service	(8,442,271)	(8,643,789)
Capital contributions	2,226,539	3,947,773
Changes in special funds, net	(2,588,393)	5,746,112
Interest expense	(1,855,718)	(1,329,828)
Net cash provided by (used for) capital and related financing activities	(12,779,843)	4,415,268
Investing Activities		
Reclassification of investments from cash & cash equivalents	1,252,876	(3,671,754)
Interest income earned on investments	111,172	70,717
Net cash provided by (used for) investing activities	1,364,048	(3,601,037)
Increase (decrease) in cash and cash equivalents	(4,725,988)	7,900,385
Cash and Cash Equivalents - beginning of year	11,177,040	3,276,655
Cash and Cash Equivalents - end of year	\$ 6,451,052	\$ 11,177,040
Reconciliation of Operating Income to Net Cash Provided by (Used for) Operating Activities		
Operating Income	\$ 3,402,734	\$ 4,062,792
Adjustments to reconcile operating income to net cash provided by (used for) operating activities:		
Depreciation and amortization	5,747,400	5,676,352
Change in accounts receivable - customer	(5,194,767)	542,418
Change in inventories	64,132	(113,493)
Change in prepaid expenses	(1,016)	(52)
Change in accounts payable	605,032	(1,043,300)
Change in customer deposits	(816,478)	157,078
Change in accrued expenses and other current liabilities	4,280,312	(857,179)
Total adjustments	4,684,615	4,361,824
Net cash provided by operating activities	\$ 8,087,349	\$ 8,424,616

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

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the City of Huntsville Electric, Natural Gas, and Water Systems (the “Utilities” or “Huntsville Utilities”) have been prepared in accordance with generally accepted accounting principles of the United States of America (“GAAP”) 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

GASB Statements No. 14 and 39 establish 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 operated by separate Boards for the electric, natural gas and water systems (collectively, the “Boards”). 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 GASB issued after November 30, 1989. The Utilities follow Statement of

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Financial Accounting Standards (“SFAS”) No. 71, *Accounting for the Effect of Certain Types of Regulation, as amended*. This standard allows utilities to capitalize or defer certain costs or revenue based on management’s ongoing assessment that it is probable these items will be recovered through the rate making process.

Huntsville Utilities has adopted the provisions of GASB Statement No. 34, *Basic Financial Statements and Management’s Discussion and Analysis for State and Local Governments*. GASB No. 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 No. 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:

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.

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.

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 GASB Statement No. 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.

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.

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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, 2011 and 2010.

Investments

Investments in U.S. Treasury, government agency, and state and local government securities are recorded at fair value, as determined by quoted market prices. Investments in overnight repurchase agreements and commercial paper are recorded at cost, which approximates fair value.

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 using the first-in, first-out consumption method of inventory accounting.

Stored Gas Inventory

Under the Federal Energy Regulatory Commission ("FERC") 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.

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Fuel Management Program

In connection with the purchase of natural gas, Huntsville Utilities has developed and implemented a procurement program intended to manage the risk of changes in the market place of natural gas. Pursuant to this program, Huntsville Utilities may execute fixed price and options contracts from time to time to help manage fluctuations in the market prices of natural gas.

Utility Plant

The Utilities maintain a \$1,000 capitalization threshold for equipment, land, buildings and improvements. 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.

Customer Deposits

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

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.

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Revenues

Revenues are recognized from meters read on a monthly basis. Service that has been rendered from the latest date of each meter-reading cycle to month end is estimated and accrued as unbilled revenue receivable. Nonoperating revenues include all other revenues not meeting this definition.

Grants in Aid of Construction

It is the Electric System's policy not to record amounts as grants in aid of construction, in accordance with guidelines established by FERC. 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.

Amortization of Debt Issue Costs

Amortization of debt issue costs and bond discounts and premiums is computed on a straight-line basis, which approximates the effective interest method over the remaining term of the outstanding bonds.

Estimates

The preparation of financial statements in conformity with GAAP 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.

Environmental Costs

Huntsville Utilities expenses, on a current basis, certain known costs incurred in complying with environmental regulations and conducting remediation activities.

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Recent Accounting Pronouncements

The GASB has issued the following statements that will be implemented; management is currently assessing the impact of these statements, however they are not expected to have a material effect on the Utilities' financial statements:

- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, issued November 2010
- GASB Statement No. 61, *The Financial Reporting Entity: Omnibus an amendment of GASB Statements No. 14 and No. 34*, issued November 2010
- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, issued December 2010
- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, issued June 2011
- GASB Statement No. 64, *Derivative Instruments: Application of hedge Accounting Termination provisions – an amendment of GASB Statement No. 53*, issued June 2011

Reclassifications

Certain 2010 amounts have been reclassified, where appropriate, to conform to the 2011 presentation.

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 2 – CASH, CASH EQUIVALENTS AND INVESTMENTS

At September 30, 2011, 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:

Description	Electric System	Natural Gas System	Water System
Cash on hand	\$ 11,451	\$ -	\$ -
Carrying amounts of:			
Deposits	25,658,893	33,336,756	16,620,355
Investments	-	8,535,466	14,597,403
Total	\$ 25,670,344	\$ 41,872,222	\$ 31,217,758
Deposits - cash	\$ 11,413,175	\$ 20,218,548	\$ 6,451,052
Investments:			
Debt service accounts	4,121,340	954,344	5,992,138
Bond construction funds	500,000	-	6,186,388
Other third party restricted	-	7,581,122	2,418,878
Board designated accounts:			
Construction	6,184,772	7,620,538	7,734,993
Insurance	1,295,631	997,670	1,000,000
Rate stabilization	-	2,500,000	-
Workers’ compensation	2,000,000	2,000,000	1,434,309
Other special funds	155,426	-	-
Total	\$ 25,670,344	\$ 41,872,222	\$ 31,217,758

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 2 – CASH, CASH EQUIVALENTS AND INVESTMENTS (Continued)

At September 30, 2011, the Utilities had the following investments held by a trustee:

<u>Investment</u>	<u>Fair Value</u>	<u>Maturity</u>
Repurchase agreement	\$ 2,705,428	11/30/22
Money Market Funds	10,339,997	Average maturity of
<u>U.S. Treasury Obligations</u>	<u>4,208,784</u>	the fund's securities
		397 days or less
	\$ <u>17,254,209</u>	

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

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

At September 30, 2011, the Utilities' investments consisted of Money Market Funds and 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 \$2.8 million at September 30, 2011 are held by the investment's counterparty, not in the name of the Utility.

Concentration of Credit Risk - Concentration of credit risk is the risk of loss attributable to the quantity of the Utilities' investment in a single issuer. Investments in single issuers that equal or exceed 5% of total investments have a reportable concentration of credit risk. Each of the investments listed above as held by a trustee represent greater than 5% of total investments.

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 3 – UTILITY PLANT IN SERVICE

Capital asset activity by System for fiscal years 2010 and 2011 is as follows:

Electric System

	Balance October 1, 2010	Additions	Retirements	Balance September 30, 2011
Land and land rights	\$ 4,420,472	\$ (300)	\$ -	\$ 4,420,172
Structures and improvements	388,584,617	9,822,459	2,701,450	395,705,626
Furniture, fixtures and other	30,387,759	1,028,970	49,229	31,367,500
 Total	 423,392,848	 10,851,129	 2,750,679	 431,493,298
Less accumulated depreciation	(185,332,593)	(16,635,948)	(2,750,679)	(199,217,862)
Construction in progress	9,975,346	8,128,692	1,309,670	16,794,368
	 \$ 248,035,601	 \$ 2,343,873	 \$ 1,309,670	 \$ 249,069,804

	Balance October 1, 2009	Additions	Retirements	Balance September 30, 2010
Land and land rights	\$ 4,309,600	\$ 110,873	\$ -	\$ 4,420,472
Structures and improvements	375,620,623	14,326,399	1,362,406	388,584,617
Furniture, fixtures and other	28,255,486	2,196,912	64,639	30,387,759
 Total	 408,185,709	 16,634,184	 1,427,045	 423,392,848
Less accumulated depreciation	(170,718,406)	(15,440,976)	(826,789)	(185,332,593)
Construction in progress	4,227,892	12,990,301	7,242,847	9,975,346
	 \$ 241,695,195	 \$ 14,183,509	 \$ 7,843,103	 \$ 248,035,601

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 3 – UTILITY PLANT IN SERVICE (Continued)

Natural Gas System

	Balance October 1, 2010	Additions	Retirements	Balance September 30, 2011
Land and land rights	\$ 1,808,035	\$ -	\$ -	\$ 1,808,035
Structures and improvements	125,017,204	3,796,152	141,061	128,672,295
Furniture, fixtures and other	9,007,933	541,100	1,134	9,547,899
Total	135,833,172	4,337,252	142,195	140,028,229
Less accumulated depreciation	(43,710,202)	(3,592,124)	(142,195)	(47,160,131)
Construction in progress	1,378,594	2,773,171	294,184	3,857,581
	\$ 93,501,564	\$ 3,518,299	\$ 294,184	\$ 96,725,679

	Balance October 1, 2009	Additions	Retirements	Balance September 30, 2010
Land and land rights	\$ 471,235	\$ 1,336,800	\$ -	\$ 1,808,035
Structures and improvements	115,215,911	9,896,548	95,255	125,017,204
Furniture, fixtures and other	8,815,190	325,315	132,572	9,007,933
Total	124,502,336	11,558,663	227,827	135,833,172
Less accumulated depreciation	(40,571,604)	(3,343,837)	(205,239)	(43,710,202)
Construction in progress	993,341	2,325,286	1,940,033	1,378,594
	\$ 84,924,073	\$ 10,540,112	\$ 1,962,621	\$ 93,501,564

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 3 – UTILITY PLANT IN SERVICE (Continued)

Water System

	Balance October 1, 2010	Additions	Retirements	Balance September 30, 2011
Land and land rights	\$ 1,746,193	\$ -	\$ -	\$ 1,746,193
Structures and improvements	231,485,032	7,849,700	240,142	239,094,590
Furniture, fixtures and other	8,174,037	191,323	13,315	8,352,045
Total	241,405,262	8,041,023	253,457	249,192,828
Less accumulated depreciation	(88,072,751)	(6,011,583)	(253,457)	(93,830,877)
Construction in progress	8,450,165	5,461,845	4,728,929	9,183,081
	\$ 161,782,676	\$ 7,491,285	\$ 4,728,929	\$ 164,545,032

	Balance October 1, 2009	Additions	Retirements	Balance September 30, 2010
Land and land rights	\$ 2,996,193	\$ -	\$ 1,250,000	\$ 1,746,193
Structures and improvements	233,655,149	2,832,368	5,002,485	231,485,032
Furniture, fixtures and other	7,684,088	556,621	66,672	8,174,037
Total	244,335,430	3,388,989	6,319,157	241,405,262
Less accumulated depreciation	(83,245,133)	(5,963,066)	(1,135,448)	(88,072,751)
Construction in progress	2,782,912	8,954,840	3,287,587	8,450,165
	\$ 163,873,209	\$ 6,380,763	\$ 8,471,296	\$ 161,782,676

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 4 – LONG-TERM DEBT

The Utilities have numerous outstanding debt obligations. A summary of the current year principal activity and a detailed description of each debt instrument is detailed below.

Principal activity for the year:

	Beginning	Additions	Retirements	Ending
Electric System	\$ 20,620,000	\$ -	\$ 3,555,000	\$ 17,065,000
Gas System	8,975,000	-	455,000	8,520,000
Water System	40,905,000	-	2,120,000	38,785,000
Total	\$ 70,500,000	\$ -	\$ 6,130,000	\$ 64,370,000

Electric System

City of Huntsville, Alabama Electric System Revenue and Term Warrants, Series 2001 - The Electric System Revenue Refunding Warrants, Series 2001 were paid off on January 3, 2011. The remaining \$2,100,000 was paid off at that time.

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	Principal	Interest	Rate	
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%	*
	4,575,000			
Current	295,000			
	\$ 4,280,000			

* - Term Warrants

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 4 – LONG-TERM DEBT (Continued)

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:

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, 2011, 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, 2011, 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, 2011, the unamortized deferred cost is \$96,815.

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

NOTE 4 – 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	Principal	Interest	Rate
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%
	12,490,000		
Current	1,070,000		
	\$ 11,420,000		

The 2007 issue contained deferred cost of \$668,300 that is being amortized over 10 years. At September 30, 2011, the unamortized deferred cost is \$452,022. The 2007 issue also contained a premium of \$264,012 that is being amortized over 10 years. At September 30, 2011, the unamortized premium is \$173,477.

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

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

The Electric System is required to establish a cash reserve fund equal to the maximum annual debt service requirement. At September 30, 2011, 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, 2011, 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.

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 4 – LONG-TERM DEBT (Continued)

Natural Gas System

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	Principal	Interest	Rate
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%
	8,520,000		
Current	470,000		
	\$ 8,050,000		

The Natural Gas System is required to establish a cash reserve fund equal to the maximum annual debt service requirement. At September 30, 2011, 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, 2011, the balance in the funds is in compliance with the indenture. The Natural Gas Revenue Warrants, Series 2005 is in compliance with Internal Revenue Code Sections 103(b)(2) and 148.

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

The 2005 issue contained deferred cost of \$241,756 that is being amortized over 20 years. At September 30, 2011, the unamortized deferred cost is \$167,208.

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 4 – LONG-TERM DEBT (Continued)

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.

The Series 2005 Revenue Warrants were issued to pay costs of capital improvements to the Natural Gas System.

Water System

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

Fiscal Year	Principal	Interest	Rate	
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%	*
	38,785,000			
Current	2,190,000			
	\$ 36,595,000			

* - Term Warrants

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

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 4 – LONG-TERM DEBT (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.

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 4 – LONG-TERM DEBT (Continued)

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.

The Water System is required to establish a cash reserve fund equal to the maximum annual debt service requirement. At September 30, 2011, the balance in the fund is the minimum required by the indenture. The bond indenture requires the Water System to establish a cash reserve account equal to one twelfth (1/12) of the principal of the Series 2008 Warrants coming due on November 1 each year and one sixth (1/6) of the interest due each year. At September 30, 2011, the balance in the fund is in compliance with the indenture. The Water System Revenue Warrants, Series 2008 is in compliance with Internal Revenue Code Sections 103(b)(2) and 148.

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

The 2008 issue contained deferred cost of \$1,120,915 that is being amortized over 25 years. At September 30, 2011, the unamortized deferred cost is \$977,139. The 2008 issue also contained a premium of \$1,340,790 that is being amortized over 25 years. At September 30, 2011, the unamortized premium is \$1,171,512.

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, 2011, the Water System also recognizes deferred costs related to prior year bond retirements in the amount of \$190,704, including related amortization expenses of \$60,220.

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 5 – 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, 2011 and 2010 are as follows:

	<u>Accrued Annual Leave</u>		<u>Accrued Sick Leave</u>	
	2011	2010	2011	2010
Electric System	\$ 2,253,152	\$ 2,126,406	\$ 874,391	\$ 809,487
Natural Gas System	809,362	766,910	163,566	245,042
Water System	901,511	852,525	493,788	383,754

NOTE 6 – DEFINED BENEFIT PENSION PLAN AND DESCRIPTION

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

The employee retirement system was established as of October 1, 1945, and placed under the management of the board of control (currently 10 members) by Act 515, Acts of Alabama 1945. Employees of the Utilities are required to contribute 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 2011 and 2010, the Utilities were required to contribute the following percentages of gross payroll to the plan:

	<u>2011</u>	<u>2010</u>
Electric System	17.71%	17.71%
Natural Gas System	11.58%	11.16%
Water System	13.83%	12.87%

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 6 – DEFINED BENEFIT PENSION PLAN AND DESCRIPTION (Continued)

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

	Annual Pension Cost (APC) 2010	Annual Pension Cost (APC) 2009	Percentage of APC Contributed 2010 and 2009
Electric System	\$ 1,815,698	\$ 1,775,412	100%
Natural Gas System	2,043,247	1,973,248	100%
Water System	646,863	634,013	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, 2010 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 each 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, 2010 was 30 years for the Gas System, 30 years for the Water System and 27 years for the Electric System.

Based on an actuarial valuation done in September 30, 2010, the most recent year for which information is available, the Schedule of Funding Progress for each system is as follows:

Electric						
Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liab. (AAL)	Funding Under(Over) AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL Percentage of Payroll
2005	\$28,094,541	\$42,619,069	\$14,524,528	65.9%	\$ 9,080,096	160.0%
2006	\$28,828,749	\$46,128,654	\$17,299,905	62.5%	\$ 9,238,666	187.3%
2007	\$29,963,494	\$47,730,823	\$17,767,329	62.8%	\$ 9,572,827	185.6%
2008	\$29,933,875	\$50,264,649	\$20,330,774	59.6%	\$10,087,229	201.5%
2009	\$29,667,953	\$52,088,628	\$22,420,675	57.0%	\$10,705,886	209.4%
2010(a)	\$29,119,209	\$55,028,226	\$25,909,017	52.9%	\$10,636,420	243.6%
2010(b)	\$29,119,209	\$55,142,084	\$26,022,875	52.8%	\$10,636,420	244.7%

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

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 6 – DEFINED BENEFIT PENSION PLAN AND DESCRIPTION (Continued)

<u>Water</u>						
Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liab. (AAL)	Funding Under/(Over) AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL Percentage of Payroll
2005	\$14,284,170	\$18,502,405	\$ 4,218,235	77.2%	\$4,600,552	91.7%
2006	\$14,848,340	\$20,040,427	\$ 5,192,088	74.1%	\$4,709,711	110.2%
2007	\$15,633,561	\$21,323,229	\$ 5,689,669	73.3%	\$5,033,225	113.0%
2008	\$15,922,622	\$23,140,702	\$ 7,218,080	68.8%	\$5,460,826	132.2%
2009	\$15,822,183	\$24,304,373	\$ 8,482,190	65.1%	\$5,579,512	152.0%
2010(a)	\$15,234,380	\$25,480,819	\$10,246,439	59.8%	\$5,487,439	186.7%
2010(b)	\$15,234,380	\$25,547,136	\$10,312,756	59.6%	\$5,487,439	187.9%

<u>Gas</u>						
Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liab. (AAL)	Funding Under/(Over) AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL Percentage of Payroll
2005	\$34,905,665	\$47,605,902	\$12,700,237	73.3%	\$13,842,546	91.7%
2006	\$36,313,068	\$51,562,348	\$15,249,280	70.4%	\$14,631,348	104.2%
2007	\$38,523,025	\$54,570,361	\$16,047,336	70.6%	\$15,942,981	100.7%
2008	\$39,258,315	\$58,009,060	\$18,750,745	67.7%	\$17,196,989	109.0%
2009	\$39,481,623	\$61,824,224	\$22,342,601	63.9%	\$18,404,081	121.4%
2010(a)	\$39,476,087	\$67,058,663	\$27,582,576	58.9%	\$19,019,754	145.0%
2010(b)	\$39,476,087	\$67,290,858	\$27,814,771	58.7%	\$19,019,754	146.2%

- a. Reflects the impact of Alabama Act 2011-27, which closes the DROP program to new applicants after March 24, 2011
- b. Reflects the impact of Alabama Act 2011-27 as well as Act 2011-676, which increases the member contribution rates by 2.25% beginning October 1, 2011 and by an additional 0.25% beginning October 1, 2012.

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

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 Internal Revenue Code 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 Utilities.

NOTE 8 – POST-EMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS

In addition to the Annual Leave and Sick Leave benefits described in Note 5 and the Pension benefits described in Note 6, the Utilities provide post-retirement Medical and nominal Life Insurance to all employees who retire from the Utilities under the provisions of the qualified plan and a minimum of 20 years of service. As of October 1, 2009, approximately 227 retirees meet those eligibility requirements. Expenses for these post-retirement benefits have previously been recognized as retirees report claims. During the year ended September 30, 2008 the Utilities implemented the provisions of GASB Statement No. 45, Accounting and Financial Reporting by Employers for Post-Employment Benefits Other Than Pensions. These provisions were applied prospectively with respect to the Utilities' other post-employment benefits plan ("OPEB"). GASB Statement No. 45 requires the accrual of OPEB obligations over the working career of plan members rather than as claims are incurred.

Annual OPEB Cost and Net OPEB Obligation - The Utilities' annual OPEB cost (expense) is calculated based on the annual required contribution ("ARC"), an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents the level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over a thirty-year period beginning October 1, 2007 with a 7% discount rate. The Utilities' annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation as of September 30, 2011 is as follows:

Fiscal Year Beginning	ARC	Annual OPEB Cost	Net OPEB Obligation
10/1/2007	\$ 1,913,794	\$ 1,913,794	\$ -
10/1/2008	2,077,691	2,077,691	-
10/1/2009	2,007,975	2,007,975	-
10/1/2010	2,193,181	2,193,181	-

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 8 – POST-EMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS (Continued)

Actuarial Method and Assumptions - Amounts determined regarding the funded status of the plan and the ARC of the Utilities are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events in the future.

The Utilities' OPEB actuarial valuation as of October 1, 2009 employed the projected unit credit method, using a level percentage of payroll, amortized over an open 30 year period. Because the unfunded actuarial liability ("UAL") is being amortized by an open or rolling amortization period (with re-amortization of the UAL in each valuation), the amortization amounts will never fully eliminate the UAL. Also, the amortization of the UAL using the current amortization method results in payments less than the "interest only" payments on the UAL. Payments less than the interest only amount will result in the UAL increasing. The investment return assumption (or discount rate) is to be selected as the estimated long-term investment return on the investments that are expected to be used to finance the payment of benefits. The Utilities selected a 7% discount rate, representing the expected return on assets invested. Health care costs were trended at an initial rate of 10% with an ultimate rate of 4.5%. The ultimate rate trends to be reached in 2026.

While the Utilities established an irrevocable trust to pay its OPEB, full funding was not made until October of 2008 after GASB Statement No. 45 was implemented. The market value of the assets as of September 30, 2009 was \$3,039,585. The Utilities' OPEB actuarial valuation as of October 1, 2009 reported present value of the OPEB as \$37,700,707, with an actuarial accrued liability of \$29,677,256. Future funding will be made each fiscal year.

NOTE 9 – CITY OF HUNTSVILLE - 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, 2011 and 2010 are as follows:

	2011	2010
Electric System	\$ 12,107,276	\$ 11,763,798
Natural Gas System	2,883,864	3,557,873
Water System	1,397,542	1,338,462

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 10 – 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 11 – 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 12 – RISK MANAGEMENT

The Utilities are exposed to various risks such as torts, theft, damage and destruction of assets; errors and omissions; natural disasters and injuries to employees. Potential losses from these risks are mitigated with a combination of commercial and self-insurance. Commercial insurance coverage is combined for the Electric, Water and Gas Utilities with the expense prorated to each department on a predetermined percentage. Coverage is provided as follows:

Blanket real and personal property	
Real property	\$ 304,787,250
Flood and earthquake	10,000,000
Blanket crime	1,000,000
Automobile liability	1,000,000
Public officials and employment liability	1,000,000
Workers compensation	
Bodily injury (accident and disease)	Statutory
Excess coverage per occurrence (SIR)	1,000,000
Comprehensive general liability	Self-insured

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

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 12 – RISK MANAGEMENT (Continued)

	2011	2010
Electric	\$ 2,000,000	\$ 2,139,489
Gas	2,000,000	2,139,017
Water	1,434,309	1,490,903
	\$ 5,434,309	\$ 5,769,409

NOTE 13 – COMMITMENTS AND CONTINGENCIES

General Litigation

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.

Redstone Arsenal Substation

The Electric System on August 12th, 2010 signed a Memorandum of Understanding with the City of Huntsville to build a substation for an estimated cost of \$6,276,000. The City will reimburse the Electric System the actual cost of this project.

NOTE 14 – TVA CONTRACT PAYABLE

The Electric System during fiscal year 2011 became aware that sums due under its power purchase contract with TVA were under-billed for each of the fiscal years 2004 through 2011. The adjustments increased the cost of power for each of the years. The balance of the outstanding unbilled contract payables was \$35,272,375 at September 30, 2010.

As of September 30, 2011, the Electric System has paid all such amounts owed to TVA retroactive to 2004.

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 15 – EXTRAORDINARY EVENT – TORNADO, APRIL 27, 2011

As has been widely reported, on April 27, 2011, at least seven tornadoes, including an F-5 strength tornado, struck portions of the State of Alabama located within the service area of the System. The tornadoes caused significant damage to the Electric System, including damage to 566 utility poles and 265 transformers. Repairs and replacement of damaged equipment were 98% completed within three weeks of the damage at an approximate cost of \$5,000,000. The Electric System expects that these repairs will be funded primarily with monies from the U.S. Federal Emergency Management Agency ("FEMA"), including \$1,131,731 in funds that have already been received and another \$2,057,000 that is anticipated to be paid to the Electric System by FEMA. The remaining amount is expected to be covered out of Electric System reserves (\$531,455) and from the State of Alabama (\$531,455). Accordingly, the Electric System does not expect to incur long-term debt in order to fund these repairs.

Similarly, the Water System expects that these repairs will be funded primarily with monies from FEMA, including \$252,315 that is anticipated to be paid to the Water System. The remaining expenses are expected to be covered out of Water System reserves (\$42,053) and from the State of Alabama (\$42,053). Accordingly, the Water System does not expect to incur long-term debt in order to fund these repairs.

NOTE 16 – SUBSEQUENT EVENTS

On December 21, 2011 the Electric System issued Electric System Revenue Warrants, Series 2011 in the amount of \$28,285,000 for the purpose of (i) providing funds to pay the costs of various public capital improvements to the System, (ii) refunding, on an advance basis, the Series 2002 Warrants, (iii) providing for a portion of the debt service reserve fund (the "Reserve Fund") established in the Indenture, and (iv) paying the costs of issuing the Series 2011 Warrants.

NOTE 17 – PRIOR PERIOD ADJUSTMENTS

Prior period adjustments were recorded to accrue payroll expense for the Electric, Gas, and Water employees. These adjustments were made so that the payroll expenses are matched with the related revenues and/or are reported when the expense occurs, not when the cash is paid. Further, an adjustment was required to restate the accrual of compensated absences. The effect on net assets and the change in net assets previously reported as a result of restating the accrual of payroll and compensated absences is as follows:

City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 17 – PRIOR PERIOD ADJUSTMENTS (Continued)

Electric:

Net assets, originally reported at 10/01/09	\$	222,084,662
Adjustment		(873,323)
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Net assets, beginning of year, restated at 10/01/09		221,211,339
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Change in net assets, fiscal year ending 9/30/10, originally reported		(1,192,737)
Adjustment		654,424
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Change in net assets, fiscal year ending 9/30/10, restated		(538,313)
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Net assets, end of year, at 9/30/10, restated	\$	220,673,026
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Natural Gas:

Net assets, originally reported at 10/01/09	\$	107,052,341
Adjustment		(251,984)
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Net assets, beginning of year, as restated at 10/01/09		106,800,357
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Change in net assets, fiscal year ending 9/30/10, originally reported		10,003,149
Adjustment		366,410
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Change in net assets, fiscal year ending 9/30/10, restated		10,369,559
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Net assets, end of year, at 9/30/10, restated	\$	117,169,916
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City of Huntsville Electric, Natural Gas, and Water Systems

Notes to the Financial Statements

NOTE 17 – PRIOR PERIOD ADJUSTMENTS (Continued)

Water:

Net assets, originally reported at 10/01/09	\$ 143,315,443
Adjustment	(370,154)
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Net assets, beginning of year, as restated at 10/01/09	142,945,289
<hr/>	
Change in net assets, fiscal year ending 9/30/10, originally reported	6,866,736
Adjustment	291,582
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Change in net assets, fiscal year ending 9/30/10, restated	7,158,318
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Net assets, end of year, at 9/30/10, restated	\$ 150,103,607
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City of Huntsville Electric, Natural Gas, and Water Systems

Required Supplementary Information

Schedule of Funding Progress for the Retiree Health Plan

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a % of Covered Payroll ((b-a)/c)
10/01/07	\$ -	\$ 25,774,602	\$ 25,774,602	0%	\$ 31,319,219	82.30%
10/01/09	\$ 3,039,585	\$ 29,677,256	\$ 26,637,671	10.24%	\$ 35,551,843	74.93%

City of Huntsville Electric, Natural Gas, and Water Systems

Schedule of Expenditures of Federal Awards and Notes to Schedule of Expenditures of Federal Awards

For the Year Ended September 30, 2011

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Pass-Through Entity Identifying Number	Federal Grant Expenditures
U.S. Department of Homeland Security			
Federal Emergency Management Agency			
Passed through Alabama Emergency Management Agency			
Federal Disaster Assistance			
Funding	97.036	FEMA-1971-DR-AL	\$ 3,318,446
Total Federal Financial Assistance			\$ 3,318,446

NOTE 1 – BASIS OF ACCOUNTING

The accompanying Schedule of Expenditures of Federal Awards is prepared on the modified accrual basis of accounting.

FUNDING PROFILES

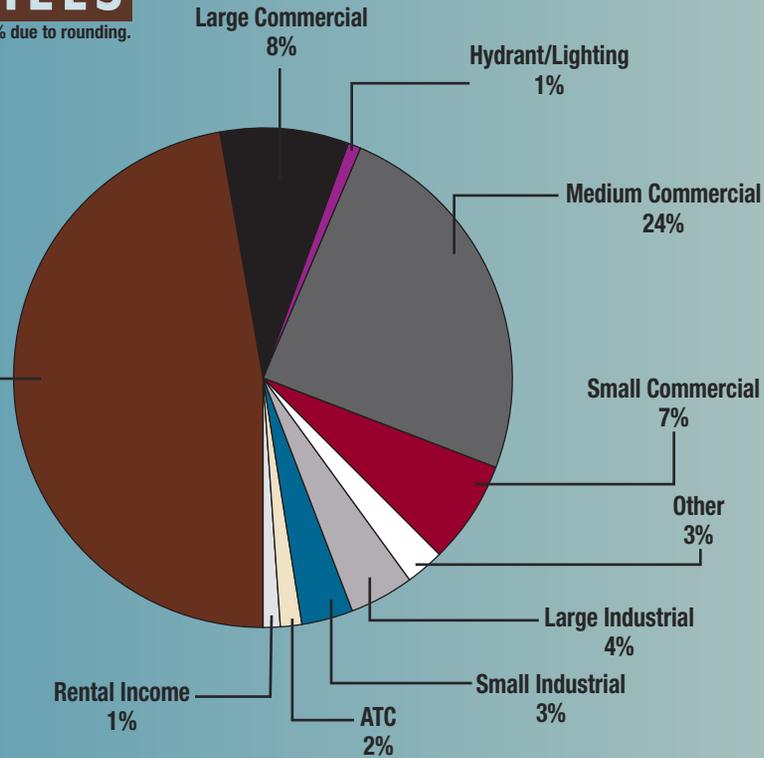
Note: Totals may not add to 100% due to rounding.



ELECTRIC

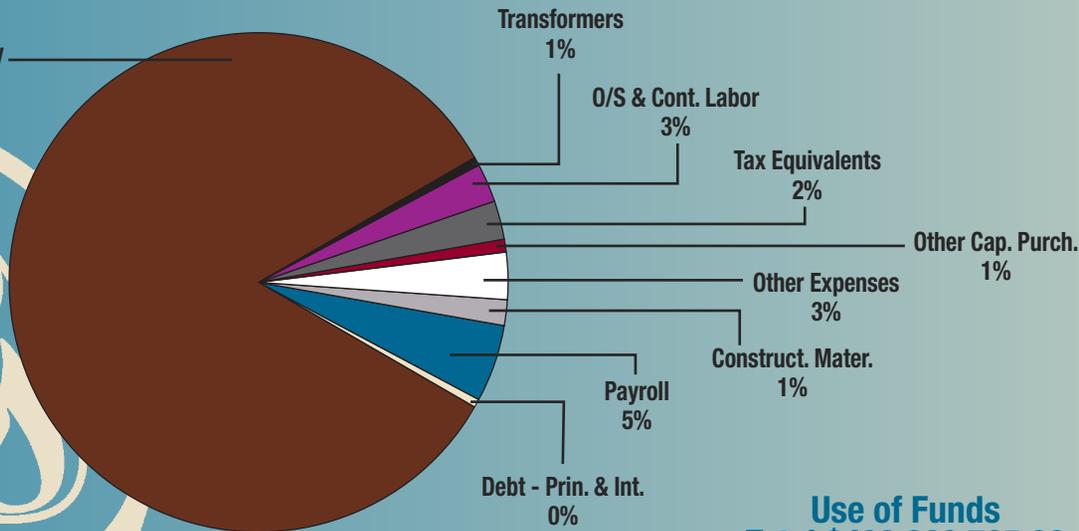
Residential Sales
47%

Source of Funds
Total \$496,311,983.58

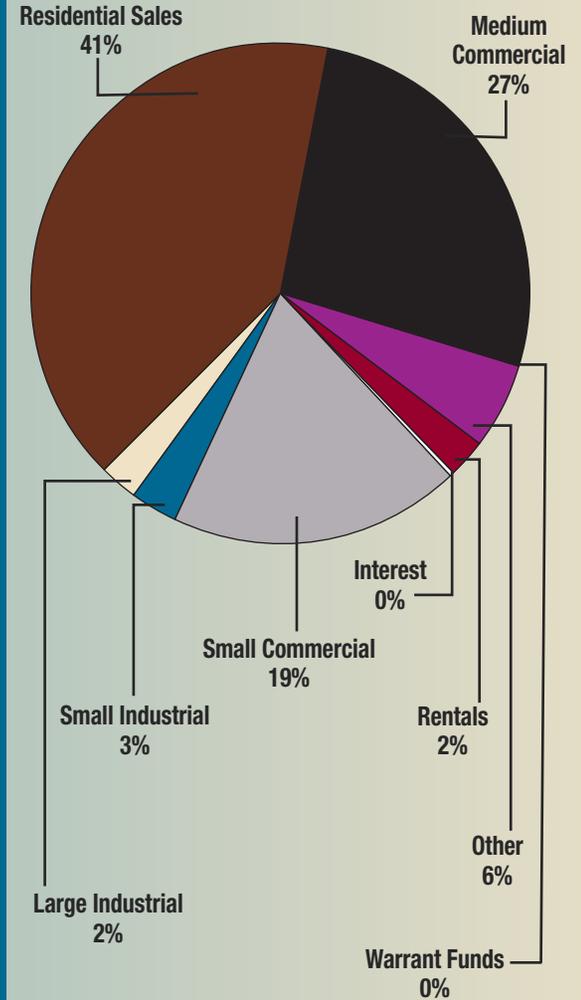


Purchased Commodity
84%

Use of Funds
Total \$490,269,795.99

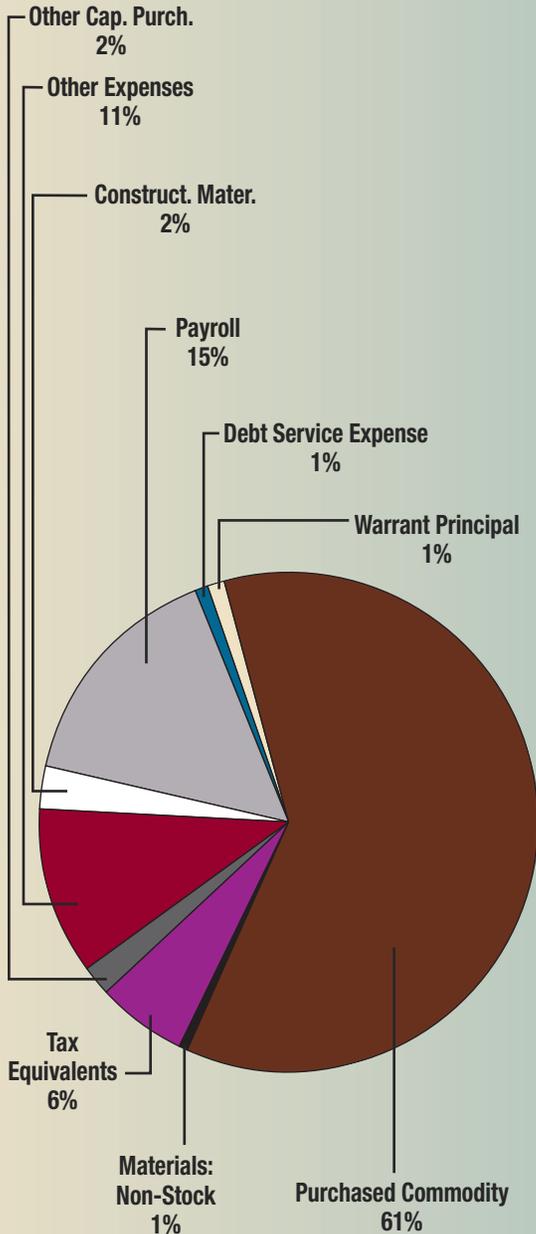


NATURAL GAS

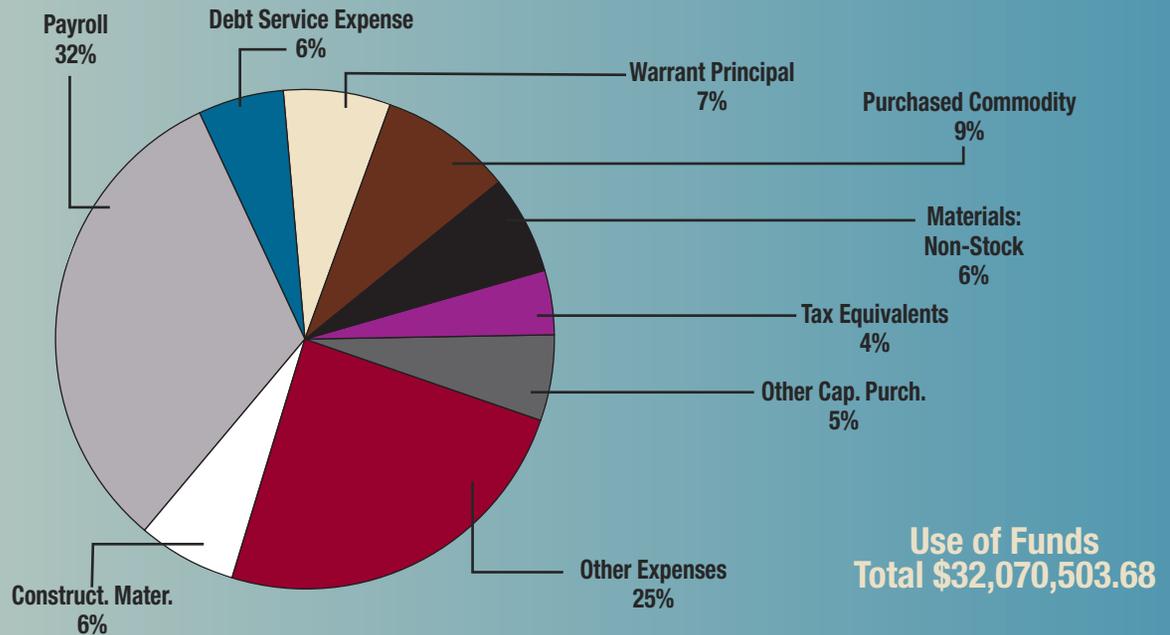
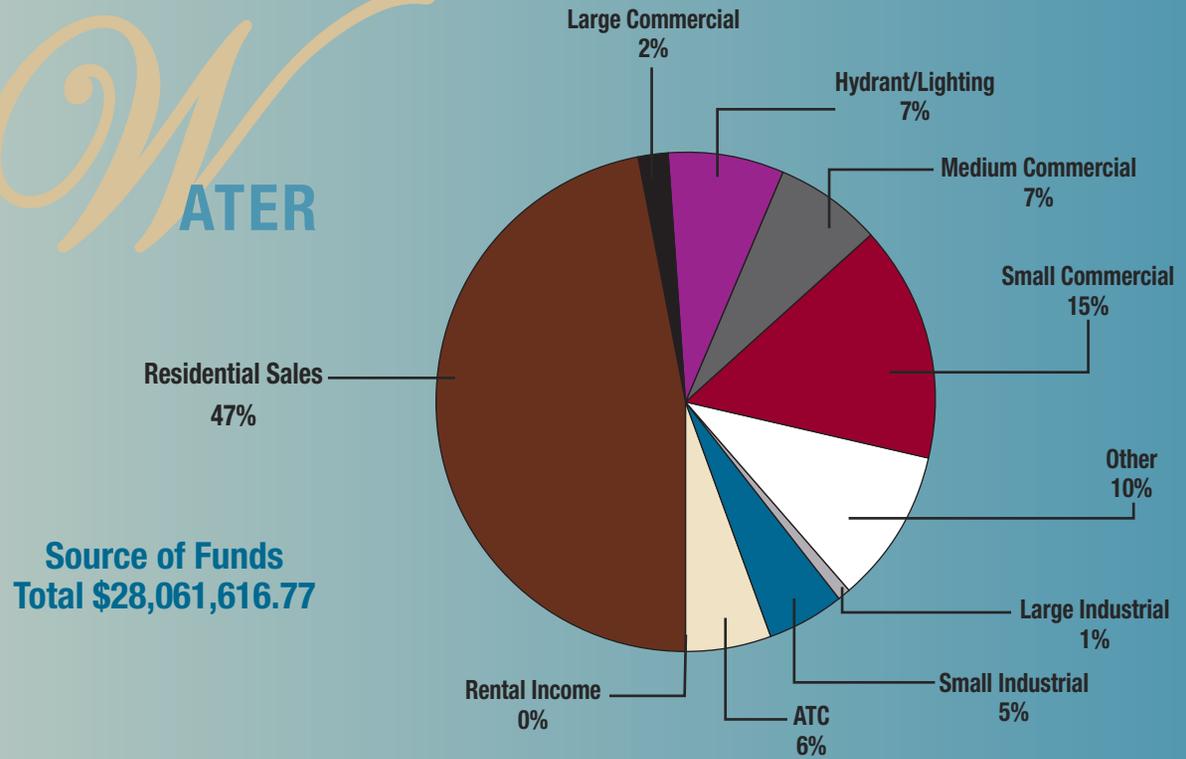


Source of Funds
Total \$51,801,085.14

Use of Funds Total \$49,300,735.18



Source of Funds Total \$28,061,616.77



Use of Funds Total \$32,070,503.68