2011 NES ANNUAL REPORT

# CONNECTIVITY


NES

# A Message From the NES President and Board Chairwoman

In a fast-changing world, our mission is constant: to provide safe, reliable and affordable power that benefits our customers, employees and community. Thanks to our solid financial foundation and a strong strategic plan, this year we've taken advantage of new opportunities to accomplish our mission better than ever – especially in the delivery and use of electricity.

Reliability of the system continued to be a main point of emphasis for Nashville Electric Service (NES). Along the way, we demolished and relocated one of our three downtown substations – Demonbreun Substation – to make way for the new Music City Center, replaced the feeder breakers at our McCrory and West Substations which were heavily damaged in the 2010 flood, and completed major upgrades of the 69kV capacitor banks at four other substations. While focusing on improved service and reliability, we continued to promote conservation as a means to reduce the environmental impact and save on our customers' electricity bills. One way was to partner with Mayor Karl Dean's office to implement the Nashville Energy Works and Greener Nashville programs.

We continued to make strides in several of the services we offer our customers. NES has been successfully using Facebook and Twitter for almost three years to engage customers in a helpful dialogue to answer their questions and concerns. In fact, NES was named a top public utility using social media, our website ranks as one of the best public utility websites nationwide and an additional 13,000 customers joined our E-bill program. We also unveiled an interactive outage map to give customers timely outage updates every 15 minutes, as well as the ability to find out the number of customers affected and whether a crew has been dispatched.

Because we believe no community can truly thrive without education, NES is coordinating the development of the Maplewood High School Academy of Energy and Power by structuring a curriculum for students interested in power distribution. Also, for the fourth year in a row, our employees' generosity to the community resulted in NES receiving the United Way Pillar Award for our 2010 Combined Needs Appeal Campaign.

The coming year will present NES with many challenges, but challenges present opportunities to serve our community in new ways. And while we are proud of this year's accomplishments, we're confident next year's achievements will be even better.

Decosta Jenkins
President and Chief Executive Officer

Mary Jo Price
Board Chairwoman

***Sizing down.*** *The use of gas-insulated substations (GIS) is rare in the United States. NES chose to install the first GIS on its system due to space constraints encountered at the Music City Center construction site.*

# THE GRID

A state-of-the-art monitoring and control system uses a fiber-optic network to check 18,000 service points every two seconds to see if anything is wrong.

At the other end of that sensor system and its modern control center are service crews and operators who are ready to spring into action the minute they know a problem has occurred. And there are other personnel who rate the criticality of customers affected by outages to decide which has the highest need.

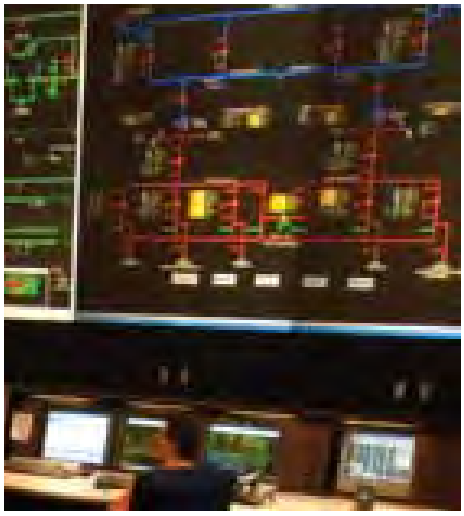
Between the control center and the more than 360,000 Nashville Electric Service customers is a massive system of transformers of all sizes, utility poles, power lines and substations. Many people simply refer to this web of equipment as "the grid."

Crew members who tend to look out for one another in a crisis and solid technology are a couple of the reasons that NES is able to serve a grid covering more than 700 square miles while at the same time winning the loyalty of customers.

"We are always trying to improve our outage restoration process, and during the past 10 years there have been some great improvements made," said System Operations Manager Jack Baxter. "NES has done it right."

Here are some factors that make the NES monitoring and response system superior to those used in many other cities of Nashville's size:

- The extensive fiber-optic cable system is able to instantly monitor conditions systemwide, whereas many other utilities' systems use slower radio technology or leased landlines to monitor system conditions.
- Customer service calls, which alert NES to problems that the monitoring and control system has not caught, are fed through a computerized system that recognizes the customer's phone number and sends service dispatchers an immediate notification.



***From low-tech to high-tech.*** *System Control operators used manually operated static boards to monitor work on the grid until they were replaced with the high-definition video wall in 2002.*

- NES has invested in a topnotch control center that oversees the entire network and ensures that problems are handled quickly and efficiently. Outages are prioritized by the needs of the customer. For instance, an outage at a hospital or nursing home would get precedence over a residential outage.
- Much of Nashville's downtown area is now served by a new substation that is completely enclosed and more space-efficient than the substation on Demonbreun Street that preceded it. The 69,000 volt transmission lines serving the new substation would normally have been run overhead on large poles, but are instead fed underground through an 8.5-foot-diameter tunnel to the gas-insulated substation, an installation that is rarely used in the Tennessee Valley Authority (TVA) territory.
- Cross-training of various types of service personnel allows employees to help one another when heavy storms or flooding strike. Some of the turf-guarding among different classifications of workers seen by other utilities is not a factor among NES employees when a crisis occurs and the grid needs repair.
- The entire downtown area in Nashville is served by a secondary network that has backup equipment for all the customers it serves. This means that if power from one source is cut off, power is immediately restored from another without the customer being aware of what has happened.

## A Witness to the Past and the Future

*It was October of 1972 when 20-year-old James Mitchell joined NES as a laborer just a few months before NES broke ground for the Demonbreun Substation in the spring of 1973. Mitchell remembers the team having to blow up solid rock in order to begin construction. Once completed, the substation served one-third of downtown Nashville.*

*Thirty-nine years and a few promotions later, Mitchell, who is now a substation field superintendent, witnessed the demolition of the Demonbreun Substation.*

*The network distribution circuits from the Demonbreun Substation were reconnected to the new Peabody Substation "one circuit at a time" without interrupting electric service to a single customer.*

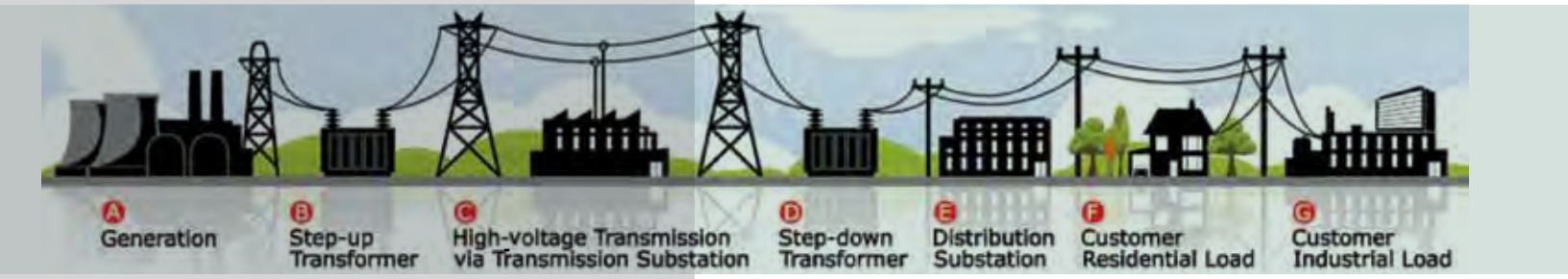
*Parts of the previous substation were then painstakingly moved to the new location at the Music City Center "one circuit at a time," recalled Mitchell.*

*Since he was hired, Mitchell has witnessed the transformation of NES, in terms of both technology and workload. When Mitchell came to work at NES, there were 34 substations; now there are 60, and the number continues to grow. The new convention center substation is a testament to the increased growth of the company and the energy demands of the city of Nashville.*

*Daniel Johnson, left, and James Mitchell help with the demolition of the Demonbreun Substation.*

**Here are some basics about how electricity is fed into the NES grid, and what happens to it once it is there:**

- There are 23 feed points coming into the Nashville area from NES' power wholesaler, the Tennessee Valley Authority. Those lines enter from various points around the city and carry power at 161,000 volts each.
- Sixty major substations are fed the high-voltage power and then transform it to voltages of either 23,900 or 13,800 volts before it is moved along in the system. (By comparison, the power lines in your home are 120 volts for most lights and appliances and 240 volts for heavy appliances like clothes dryers.)
- This power is then carried to other places for transformation. In all, there are 233 distribution substations and nearly 91,000 transformers (green boxes on the ground or gray cans atop poles you see in many neighborhoods) that come into play in reducing voltage and distributing the power.
- During the process, the power runs through 5,700 miles of lines that are held up by more than 200,000 utility poles.
- The substations, transformers and other major equipment mentioned above are constantly monitored using the fiber-optic network system, a set of lines separate from the electrical ones. The backup reporting system for outages rests with NES customers, whose reports by telephone help NES monitor and fix problems.
- This system does a great job of watching for problems and issuing alerts for neighborhoods across Nashville. The natural next step will be to extend that network so that it can be in touch with homes and businesses in a continuous way to ensure even greater reliability.



# THE SUBSTATION

When city developers began planning the construction of the Music City Center, they realized that one of Nashville Electric Service's three downtown substations would need to be relocated to make room for the new convention center.

What the developers thought would be a simple project turned out to be much more than they had anticipated. NES reviewed the convention center authority's plan, and as Civil and Environmental Engineering Manager Wes Allen said, "Immediately we noticed something wrong."

To move the entire facility about 800 feet, from the corner of Sixth Avenue South and Demonbreun Street to the corner of Sixth and Peabody Street, would require a substantially larger investment of time and money than had been budgeted. Since the entire downtown business district relies on NES' three central substations for power, relocating one of them would pose an enormous challenge in terms of maintaining a reliable, integrated downtown secondary network.

The city's growing anticipation of a larger convention center flooded the minds of key decision-makers. The economic future of downtown Nashville hung in the balance, and NES had to act quickly.

Faced with such a daunting task, NES saw this as an opportunity, not only to pave the way for a huge civic project, but also to go above and beyond a simple relocation. To NES, this project provided the motivation to make the entire downtown secondary network more efficient and reliable.

NES first consulted with the convention center authority to divide responsibilities. Music City Center would pay for and handle all of the civil infrastructure and preparations for the new site, while NES would design and manage the relocation and solicit proposals for a contractor to set and install the new equipment.

Such a swift and confident leap to action is noteworthy on its own, but the innovative ideas that NES incorporated have made this project a model for substation relocation and improvement.

For the first time ever, NES hired a contractor to build a substation. Aubrey Silvey Enterprises won the bid with its plan to build a gas-insulated substation (GIS), a departure from traditional air-insulated substations.

*The new Peabody Gas-insulated Substation, that replaced the 38-year-old Demonbreun Substation, reduced the size of the substation footprint by 50 percent.*

Of the 60 substations located on the NES power grid, the new Peabody Substation is the only GIS system. Gas insulation is rare in the U.S., and these systems are used primarily when there is a significant space constraint, which was another issue facing the substation developers. The construction process lasted nine months, beginning in October 2010 and ending in July 2011. The speed with which the new substation became a reality is even more remarkable considering all of the improvements NES incorporated into the project.

The Peabody Substation is the only facility of its type that is completely enclosed. The substation features a much-improved, more reliable distribution switchgear system, which contributes to better overall integration between the downtown facilities.

The single most significant feature of the new substation, however, is the 3,000-foot-long and 150-foot-deep tunnel that NES built to house the transmission lines that feed into the facility. Never before has NES buried 69kV distribution lines in an underground tunnel, and never before has the company engaged in a project of such enormous scope.

"Along with the GIS, another unique component of this project is the transmission tunnel," said Allen.

The tunnel, which is 8.5 feet in diameter, brings two overhead transmission lines that feed the downtown area underground and out of sight.

The Peabody Substation powers about one-third of the downtown business district, just like the old station; but beneath the surface and behind the enclosure is an innovative facility that more reliably connects the downtown secondary network. When NES officially made the switch from the old substation to the new one in July, lights didn't flicker, computers didn't restart, and clocks didn't reset to 12:00. Hardly anyone noticed, just as NES had hoped.

Over the past few years, NES has been faced with a number of daunting challenges, from flood response to a relocation project with unexpected significance. But much like the city of Nashville, NES met those challenges with ambition and innovation, corporate values that are reflected by the new Peabody Substation and the underground transmission tunnel.

***In support of the Peabody Substation project, NES:***

- *Replaced 27 network transformers*
- *Replaced 97 network protectors*
- *Upgraded 112 network protector relays*
- *Installed 28,642 feet of primary cable*
- *Installed 6,006 feet of secondary cable*
- *Installed 24,027 feet of ground wire*
- *Installed 25,064 feet of control cable*
- *Installed 2,352 feet of fiber-optic cable*

# HOW AN OUTAGE IS HANDLED – MINUTE BY MINUTE

**9:47 a.m.**

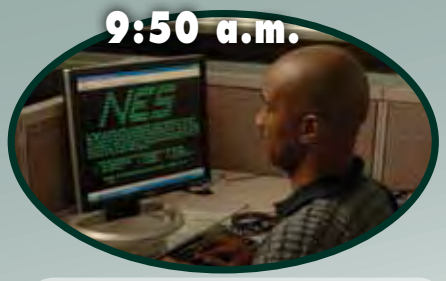
The monitoring and control system at NES discovers a major outage in the Madison area of Nashville. More than 170 miles of fiber-optic cable is connected with NES substations and gathers status information every two seconds.

**9:48 a.m.**

Global positioning transmitters on NES vehicles show that a control operator and a bucket truck are near the Madison area. Both are immediately dispatched to the neighborhood.

The average outage during nonstorm conditions lasts less than an hour.

**9:50 a.m.**




The first of several residential customers' calls to report an outage is received. The customer's information helps with pinpointing the heart of the problem.

**9:51 a.m.**

NES system operators in the Control Center check to see if there are customers in the area that are a top priority for power restoration. Hospitals, police centers, nursing homes and other vital facilities fall into this category.

**9:52 a.m.**

The NES Control Center receives a call from the Office of Emergency Management via the NES–OEM direct phone line that they have a report of a car hitting a power pole on Gallatin Road. The control operator and bucket truck are rerouted to the scene of the accident to assess the damage and assist Metro's first responders.

**9:53 a.m.**

It is discovered that a nursing home lies within the affected area. NES system operators contact additional personnel to begin the process of switching load to run power from a secondary source to that facility.

## 10:12 a.m.

Line workers arrive on the scene of the accident and begin securing the broken pole and downed power lines.

## 10:14 a.m.

The additional control operators called to switch the nursing home to an alternative source have completed their switching operations and have restored power to the nursing home. They now head to the scene of the accident to provide additional support if needed.

## 9:59 a.m.

Though it is raining, there are not heavy storms in the area. It does not appear that weather caused the outage. Nonetheless, NES System Operations officials call colleagues in Jackson, Tenn., to see whether harsher weather is approaching. It appears that the weather that passed through Jackson three hours ago was not severe.

## 10:15 a.m.


Updates are sent to customer service representatives, and the problem and number of affected customers are updated on the NES website. Notices are also placed on the NES Twitter and Facebook pages.

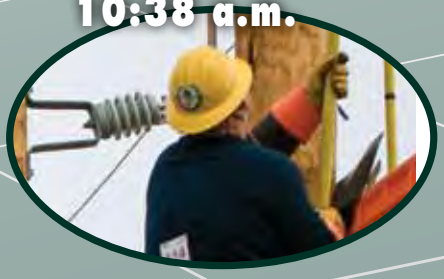
## 10:22 a.m.

System operators in the Control Center have completed a switching plan that will restore power to all customers and kill power on each side of the damaged pole, so line crews can set a new pole and make permanent repairs.

## 9:55 a.m.

The NES control operator arrives on the scene of the problem.

## 10:38 a.m.



Control operators complete field switching operations, power is restored to all customers, and line crews can safely begin their work to replace the damaged pole and lines.

The NES outage website is updated, and automated calls go to customers who had reported outages by phone and requested a call back to be sure that their power has been restored.

## Guardian Angels

*To NES retiree Benjamin Poss, NES employees Alan Nelson and Kurt Hellmann are more than lineworkers. Poss calls them his guardian angels.*

*On May 21, Benjamin Poss and his wife were stopped at a traffic light when he suffered cardiac arrest.*

*Fortunately, Nelson and Hellmann were stopped directly behind him. When Poss' car did not move, they assumed the car had broken down and jumped out to offer assistance. When a female passenger yelled out that her husband was having a heart attack, the employees knew they had to act fast.*

*Nelson rushed to the victim and Hellmann ran back to the truck to retrieve the automated external defibrillator (AED) that had recently been installed in the truck. Poss was not breathing and had no pulse. Nelson pulled him from the car and started to administer CPR. Once Hellmann returned with the AED, the employees shocked the victim's heart back into rhythm before the paramedics arrived.*

*Unknown to the employees at the time, Poss was a retired NES employee. He retired in 1990 after 34 years of service.*

*Poss survived the ordeal and has since had a defibrillator/ pacemaker implanted. According to medical personnel, the outcome would have been much worse if not for the AED technology and the immediate actions taken by Nelson and Hellmann.*

*When the Chattanooga EPB electrical grid suffered widespread damage as a result of tornadoes in April 2011, NES sent 50 linemen to Chattanooga to assist with storm restoration efforts.*

# LINEWORKERS: THE KEY TO MAINTAINING A RELIABLE GRID

After 25 years as an NES lineworker and 40 hours a week of practice and preparation for four weeks, Steve Stubblefield was ready for the APPA Lineworkers Rodeo – an annual test of skill and knowledge that has become the equivalent to the Super Bowl for public utilities across the country. Only this year, Steve, whose nickname is "Tall Pine," and the rest of the NES team didn't have to make travel arrangements to participate in the competition because it was held in Nashville for the first time.

The rodeo was a good example of the dedication, knowledge and proficiency that it takes to make a successful team of lineworkers – all of which were displayed by the NES participants in the competition. Fifty-five teams and 76 apprentices competed in the event. One of NES' teams finished in fourth place overall, and an NES apprentice lineworker finished fifth overall in the apprentice competition.

NES lineworkers are an integral part of Nashville's electrical infrastructure because the grid is only as reliable as the employees who are tasked with keeping it operational. Every time we turn on the lights, watch cable television, make a call from a landline or access the Internet, we are relying on a network of lines and cables – known as the grid – to provide us with electricity and to connect us with the outside world.

Fortunately, NES has some of the best lineworkers – the first responders who are responsible for restoring power after an outage – in the nation. In addition to maintaining and repairing the grid, NES' lineworkers are also responsible for expanding the infrastructure by installing new utility poles, transformers and power lines in order to keep pace with Nashville's residential and commercial growth.

In a year like 2011, which saw an increase in severe weather conditions, employing an exceptional team of lineworkers is critical for a city to maintain the reliability of its electrical infrastructure. In 2011, NES' lineworkers were called on to restore power for 17 major outages caused by severe weather and other factors, returning power to more than 385,000 customers combined.

"I am extremely proud of our line crews and the way they responded to the numerous storms that affected the NES system this year," said Dennis Boehms, NES VP of Operations. "They worked long hours in extreme conditions to restore power to NES customers. Most importantly, they worked safely and were able to go home to their families."

Although severe weather can be unpredictable, NES lineworkers are trained to expect the unexpected, and any time customers report an outage, lineworkers are immediately dispatched to find the cause of the outage and make repairs in order to restore power efficiently and safely.

Due to the nature of the work, the most important aspects of lineworkers' jobs are safety and efficiency, both of which are emphasized by NES and put to the test on a regular basis – through training exercises and competitions, such as the APPA Lineworkers Rodeo, and also on a daily basis as lineworkers are called on to keep Nashville's grid operational. Whether it's the safety tips that are read before all meetings at NES, the defensive-driving training courses that are provided or the purchase of 125 AEDs for NES line trucks – NES management places a premium on educating lineworkers about the importance of workplace safety.


*NES lineworkers practice their safety skills in a cover-up training session. The cover-up training course teaches lineworkers how to properly cover all energized line parts and paths to the ground while making repairs to the grid.*


*NES is leading the way in the adoption of electric vehicles, which save money at the gas pump and are environmentally friendly.*

## GREENING THE GRID

Nashville Electric Service has long been committed to encouraging energy conservation among our customers. As Nashville's only public power provider, NES also recognizes our significant responsibility to make energy-efficiency a key part of our corporate culture.

Over the past year, NES has collaborated with our customers to "green" the grid, while also sharpening our commitment to environmental stewardship from within our own walls.

In April 2011, NES partnered with Mayor Karl Dean's office and the Tennessee Valley Authority (TVA) to launch Nashville Energy Works, an initiative that offers significant financial incentives to customers who make energy-efficient upgrades to their homes.

When an NES customer signs up for Nashville Energy Works, trained energy advisers from subcontractor Conservation Services Group (CSG) come to the customer's home for an extensive energy evaluation. After the inspection, CSG presents the homeowner with specific suggestions for energy improvements, as well as the projected savings associated with those upgrades.

Should the customer elect to make the recommended installations, he or she solicits bids from members of an approved contractor network. After the selected contractor completes the renovations, CSG returns to the home for a quality assurance inspection, at which point the customer becomes eligible for up to $500 in rebates.

But the savings don't end there. By making energy-efficient upgrades to their homes, customers will soon begin to see lower monthly power use, and the entire city benefits.

"Energy-efficiency is a virtual power plant," Energy Services Manager Jim Purcell said. "If we provide incentives for customers to save energy, it could help keep rates lower and keep additional power plants from being built."

While the in-home energy evaluations require the cooperation of customers, other internal NES initiatives are having significant impacts on "greening" the power grid and promoting a company culture of conservation.

This past year, for example, NES installed new, energy-efficient lightbulbs and upgraded plumbing fixtures at its downtown headquarters, measures which have reduced electrical consumption by 11 percent and water usage by 18 percent.

Furthermore, NES has not purchased new oil to operate its transformers in three years. That's because the company employs an oil-purification process that recycles about 60,000 to 80,000 gallons of oil annually.

When NES decommissions a transformer, engineers remove the water from all of the noncontaminated oil and re-inject specific additives found in domestic-use oil that had been lost during the transformer's work cycle. If this oil weren't recycled, it would be burned for energy use.

There are still many transformers out in the field that require oil to operate, but the new transformers actually use a much cleaner product – FR3 soybean oil. According to NES Environmental Engineering Supervisor Robert Helbig, the utility is trying to eventually stop using standard oil altogether.

"As much as we're recycling, and with new transformers being installed all over the city, we're hoping we'll never have to purchase new oil again," he said.

NES is also at the forefront of a movement that, in the long run, could help reduce our country's seemingly unquenchable thirst for oil. In June 2011, NES purchased three new Nissan Leaf electric cars, wrapped them in company logos and asked employees to get behind the wheels.

The initiative is perhaps the most visible indication of the company's commitment to environmental awareness, and NES hopes that Nashville residents will follow its lead in making the switch to electric vehicles and saving money at the gas pump.

Vic Hatridge of Information Systems drove one of the new Leafs more than 1,500 miles in the first two months after they arrived at NES, and he estimated he drove approximately four miles per kilowatt hour charged.

That rate converts to 2.5 cents per mile, and in two full months, it has cost him only $38 to charge the vehicle. True, an influx of electric vehicles would present the power grid with a substantial load increase, but the cost and energy savings occur at the pump.

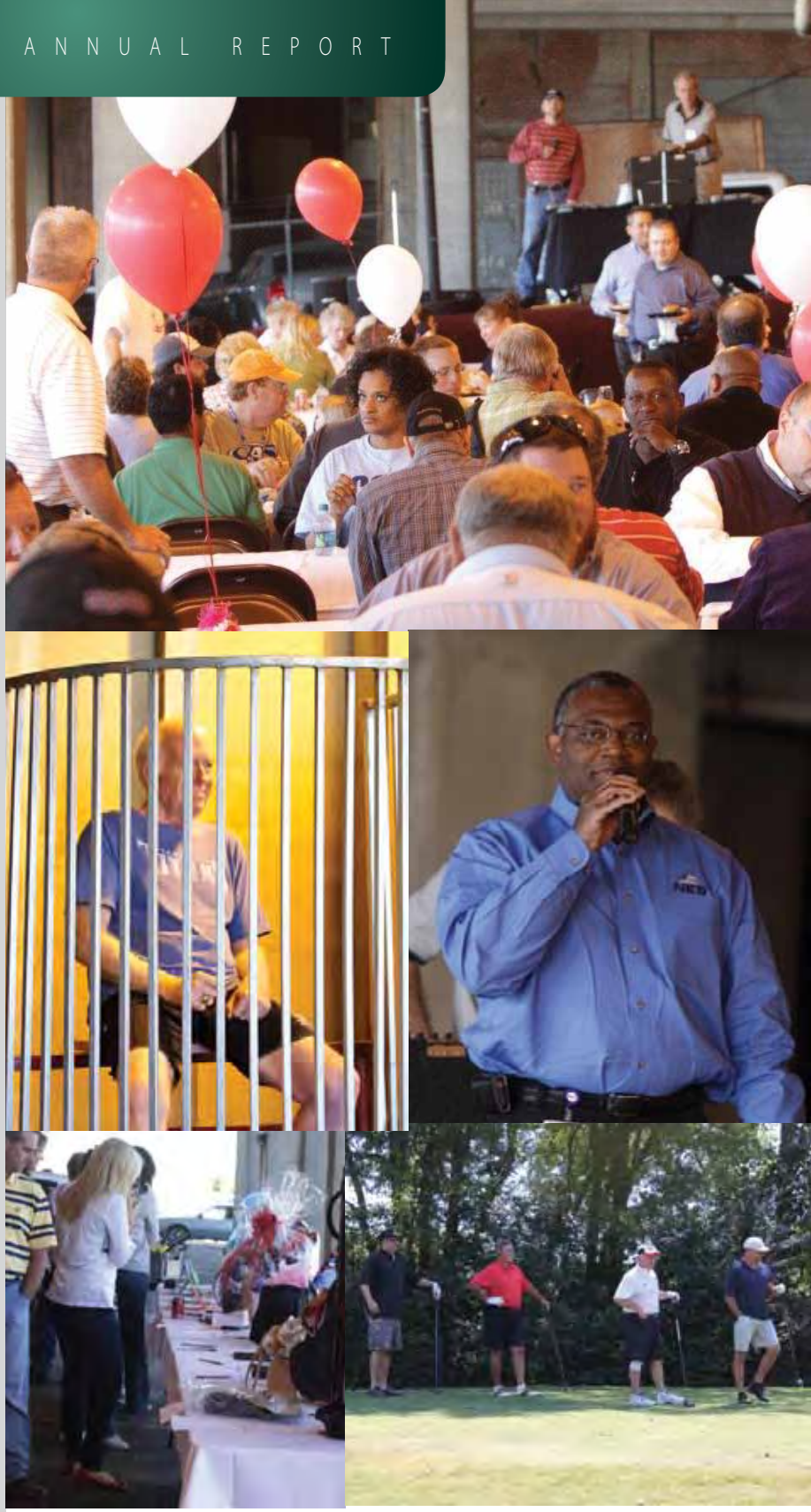
"It is amazingly cost-efficient when you consider how much it would cost to drive a gas-powered vehicle 1,500 miles," Hatridge said.

From incentive-based energy evaluations to oil reclamation and electric vehicles, NES is pulling out all the stops to prove it is committed to helping Nashville reduce its overall energy usage. Environmental stewardship is NES' passion, and we are excited to lead this city into a new era of conservation and sustainability.

NES has not purchased new oil to operate its transformers in three years … the company employs an oil-purification process that recycles about 60,000 to 80,000 gallons of oil annually.

*In 2010, NES employees raised more than $150,000 in support of the United Way, Community Shares and Community Health Charities, bringing the total raised since 2005 to more than $755,000.*

*NES employs interns from Maplewood High School and is coordinating the development of the Maplewood High School Academy of Energy and Power by structuring a curriculum for students interested in power distribution.*



*NES employees raise money for the American Heart Association by participating in golf tournaments and company-sponsored luncheons.*

## AT NES, LENDING A HAND IS INGRAINED IN COMPANY CULTURE

When NES linemen are working tirelessly in their aerial bucket trucks to restore power following a storm, their contributions to the community are highly visible, as are the results – the refrigerator starts cooling again, and the lights come back on.

The same can be said for employees who work outside the grid, such as the customer service representatives who answer questions and solve problems, and energy auditors who help homeowners conserve energy and save money.

The contributions to the community don't stop there, however. Employees throughout the company lend a helping hand to a variety of organizations and support an array of good causes every year, both in volunteer time and in helping raise money.

"NES is fortunate to be an organization that has the resources and the employees to be able to give back to the Nashville community," said Holly Lively, a customer engineering supervisor at NES. "For this reason, NES really strives to foster a 'pay-it-forward' attitude within its company culture and its employees. It is not enough to merely keep the power on; we need to do more for a community that has provided us with so much."

Every year the company's Community Action Team, made up of six NES employees, conducts a companywide poll to determine which four organizations NES individuals want to sponsor that year.

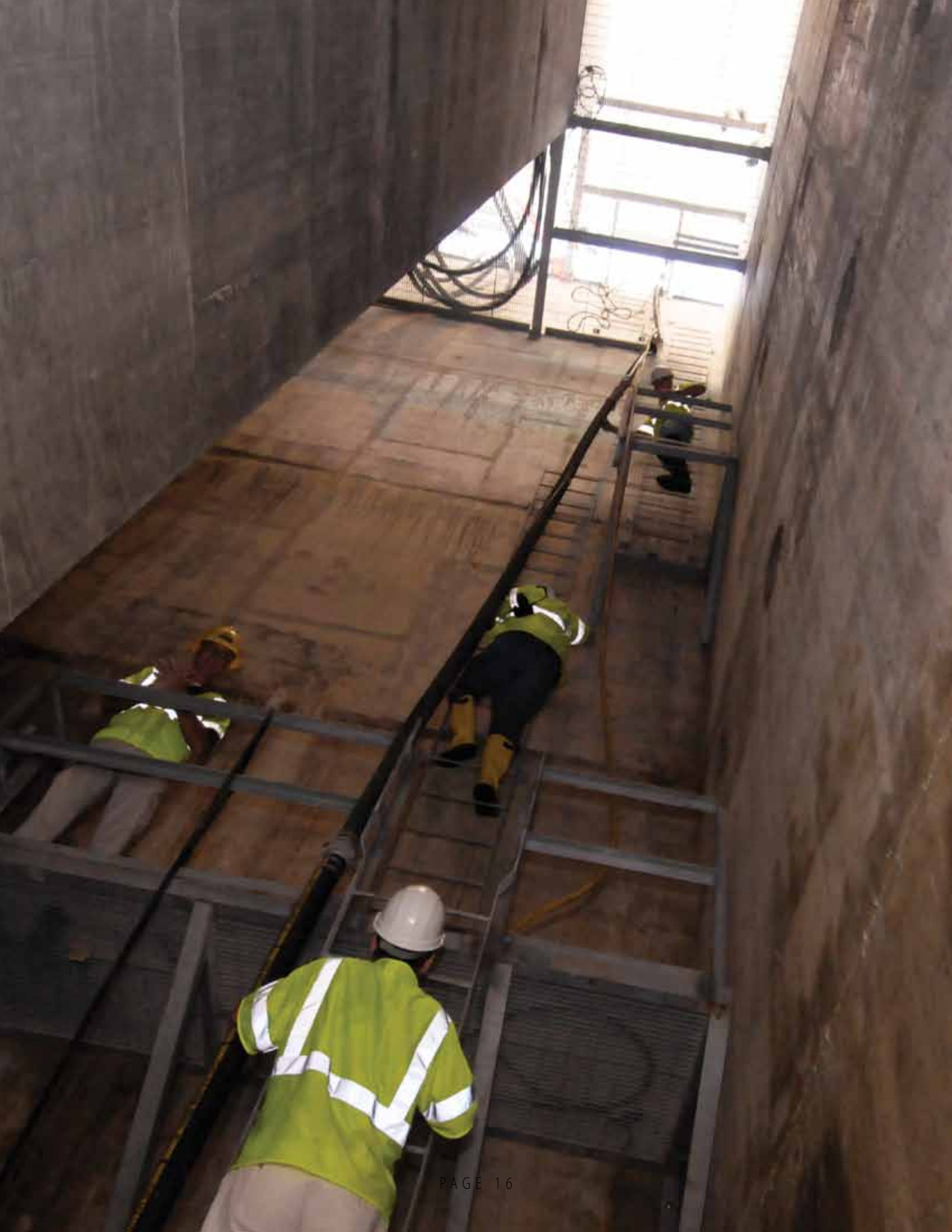
The largest beneficiary of NES, and one that has been selected by the employees for the past few years, is the American Heart Association (AHA). In 2010, NES raised more than $22,000 for the association through three major events: the annual American Heart Association Walk, mini-fundraisers conducted by NES employees and a company-sponsored luncheon. In addition, proceeds from the Ricky Joe Invitational Golf Tournament, named in memory of deceased NES employee Ricky Joe Perrigo, are contributed to the AHA fund.

NES employees also enthusiastically support The Salvation Army's annual Angel Tree event. The utility has provided gifts for up to 100 underprivileged families for the past two holiday seasons.

Another highly popular initiative comes through the Employee Combined Needs Appeal Campaign, which allows employees to deduct money from their monthly paychecks and pledge it toward a charity of their choice.

In 2010, NES raised more than $150,000 from about 400 employees in support of the United Way, Community Shares and Community Health Charities. That effort resulted in the United Way awarding NES a Pillar Award for its tremendously successful campaign.

*"We're very proud of the spirit of volunteerism here at NES," said NES Chief Executive Officer Decosta Jenkins. "It's something that the employees initiate and drive, and it definitely carries over into their day-to-day jobs."*



# ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

## FINANCIAL STATEMENTS FOR THE YEARS ENDED

## JUNE 30, 2011 AND 2010

# EXECUTIVE MANAGEMENT

**Allen Bradley**
Executive Vice President and
Chief Operating Officer

**Teresa Broyles-Aplin**
Vice President of Finance
and Administration and
Chief Financial Officer

**Decosta Jenkins**
President and
Chief Executive Officer

# BOARD MEMBERS

**Mary Jo Price**
NES Board Chairwoman

University Counsel
Office of General Counsel
Vanderbilt University

**Richard Courtney**
Broker
Pilkerton Realtors

**Sam Howard**
Chairman
Phoenix Holdings
Inc.

**Rob McCabe**
Chairman
Pinnacle Financial
Partners

**Yanika Smith-Bartley**
Director
Legal Counsel
Asurion

**ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY**
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Electric Power Board of the Metropolitan
Government of Nashville and Davidson County
Nashville, Tennessee

We have audited the accompanying statement of net assets of the Electric Power Board of the Metropolitan Government of Nashville and Davidson County (the "Board"), a component unit of the Metropolitan Government of Nashville and Davidson County, Tennessee, as of and for the year ended June 30, 2011, and the related statements of revenues, expenses and changes in net assets and of cash flows for the year then ended. These financial statements are the responsibility of the Board's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Board's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Board, as of June 30, 2011 and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

Deloitte & Touche LLP

October 19, 2011

CROSSLIN &ASSOCIATES
CERTIFIED PUBLIC ACCOUNTANTS

## INDEPENDENT AUDITORS' REPORT

Members of the Electric Power Board of the
Metropolitan Government of
Nashville and Davidson County
Nashville, Tennessee

We have audited the accompanying statement of net assets of the Electric Power Board of the Metropolitan Government of Nashville and Davidson County (the "Board"), a component unit of the Metropolitan Government of Nashville and Davidson County, Tennessee, as of June 30, 2010, and the related statements of revenues, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Board's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Board as of June 30, 2010, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

Crosslin & Associates, P.C.

Nashville, Tennessee
October 29, 2010

## *MANAGEMENT'S DISCUSSION AND ANALYSIS*

As financial management of the Electric Power Board of the Metropolitan Government of Nashville and Davidson County (the "Board"), we offer readers of these financial statements this narrative overview and analysis of the financial activities of the Board for the fiscal years ended June 30, 2011 and 2010 as compared to fiscal years 2010 and 2009, respectively. In conducting the operations of the electrical distribution system, the Board does business as Nashville Electric Service ("NES"). NES is a component unit of the Metropolitan Government of Nashville and Davidson County, Tennessee. This discussion and analysis is designed to assist the reader in focusing on the significant financial issues and activities and to identify any significant changes in financial position. We encourage readers to consider the information presented here in conjunction with the financial statements taken as a whole.

### Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to NES' financial statements, which are comprised of the basic financial statements and the notes to the financial statements. Since NES is comprised of a single enterprise fund, no fund-level financial statements are shown.

### Basic Financial Statements

The basic financial statements are designed to provide readers with a broad overview of NES' finances in a manner similar to that of a private-sector business.

The statements of net assets present information on all of NES' assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of NES is improving or deteriorating. Net assets increase when revenues exceed expenses. Increases to assets without a corresponding increase to liabilities results in increased net assets, which indicates an improved financial position.

The statements of revenues, expenses and changes in net assets present information showing how NES' net assets changed during the fiscal year. All changes in net assets are reported as soon as the underlying event occurs, regardless of timing of related cash flows. Thus, revenues and expenses are reported for some items that will only result in cash flows in future fiscal periods (e.g., earned but unused vacation leave).

The statements of cash flows present changes in cash and cash equivalents resulting from operating, financing, and investing activities. These statements present cash receipts and cash disbursements information, without consideration as to the timing for the earnings event, when an obligation arises, or depreciation of capital assets.

### Summary of Changes in Net Assets

Assets exceeded liabilities by $530.7 million at June 30, 2011, and $501.8 million at June 30, 2010. This represents an increase of $28.9 million in 2011 and $13.7 million for 2010.

The largest portion of the Board's net assets reflects its investment in capital assets less any related debt used to acquire those assets that is still outstanding. The Board uses these capital assets to

## MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)

provide service and consequently, these assets are not available to liquidate liabilities or for other spending.

An additional portion of the Board's net assets represents resources that are subject to external restrictions on how they may be used. These restrictions include bond proceeds to be used for construction projects and reserve funds required by bond covenants.

### STATEMENTS OF NET ASSETS ($000 omitted)

| | June 30, | | |
|---|---|---|---|
| | 2011 | 2010 | 2009 |
| **ASSETS** | | | |
| **CURRENT ASSETS** | $ 329,741 | $ 265,956 | $ 231,927 |
| **INVESTMENT OF RESTRICTED FUNDS** | 55,261 | 91,337 | 125,907 |
| **UTILITY PLANT, NET** | 842,384 | 819,335 | 798,405 |
| **ENERGY CONSERVATION PROGRAMS' NOTES RECEIVABLE** | 884 | 227 | 366 |
| **OTHER NON-CURRENT ASSETS** | 2,566 | 2,831 | 3,084 |
| **TOTAL ASSETS** | 1,230,836 | 1,179,686 | 1,159,689 |
| **LIABILITIES** | | | |
| **CURRENT LIABILITIES** | 198,213 | 168,554 | 144,141 |
| **CURRENT LIABILITIES PAYABLE FROM RESTRICTED ASSETS** | 22,113 | 18,350 | 18,075 |
| **LONG-TERM DEBT, LESS CURRENT PORTION** | 467,103 | 487,142 | 506,027 |
| **OTHER NON-CURRENT LIABILITIES** | | | |
| Payable to TVA – energy conservation programs | 785 | 227 | 366 |
| Other | 11,926 | 3,604 | 2,976 |
| | 12,711 | 3,831 | 3,342 |
| **COMMITMENTS AND CONTINGENCIES** | | | |
| **TOTAL LIABILITIES** | 700,140 | 677,877 | 671,585 |
| **NET ASSETS** | | | |
| Invested in utility plant, net of related debt | 358,152 | 355,501 | 350,101 |
| Restricted | 52,536 | 52,177 | 52,854 |
| Unrestricted | 120,008 | 94,131 | 85,149 |
| **TOTAL NET ASSETS** | $ 530,696 | $ 501,809 | $ 488,104 |

**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

**Liquidity and Capital Resources**

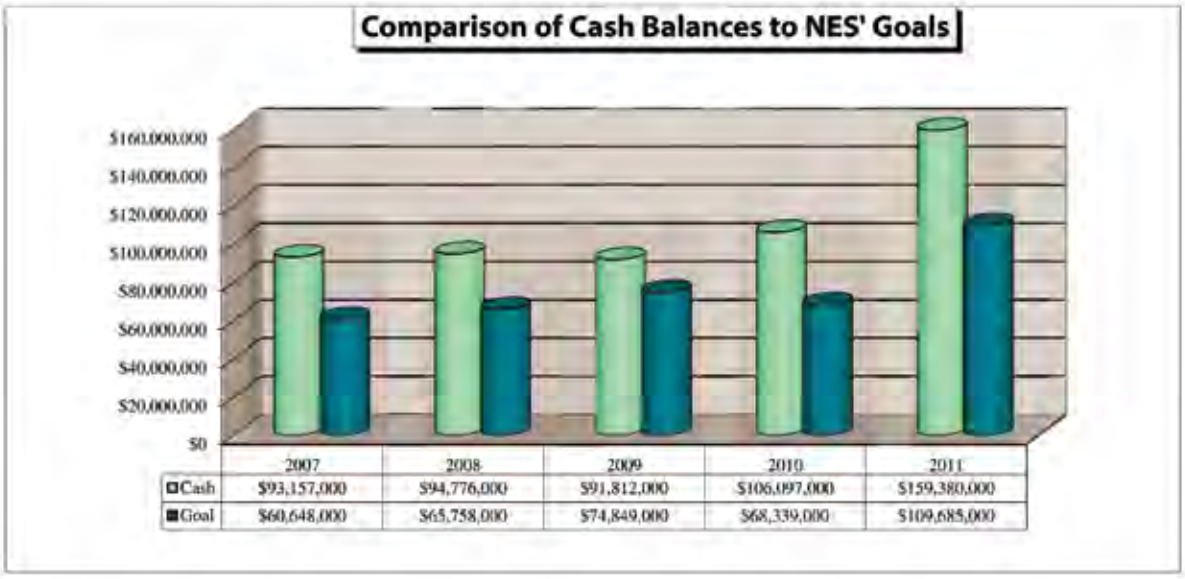
The Board has sufficient debt capacity and a strong financial position. Therefore, the tax-exempt bond market is expected to be a future source of liquidity to supplement the cash flow from operations. On June 27, 2008, the Board closed on the sale of the Metropolitan Government of Nashville and Davidson County, Tennessee, Electric System Revenue Bonds, 2008 Series A and B. The purpose of the 2008 Series A Bonds was to reimburse NES for a portion of the 2008 capital expenditures and to fund approximately 50 percent of NES' projected $218.9 million Capital Budget for the fiscal years ended June 30, 2009, through June 30, 2011. The remainder was funded with operating revenues. During fiscal year 2011, NES drew down $36.4 million from these funds for capital expenditures.

In addition to operating cash flow and proceeds from tax-exempt bonds, the Board had a $25 million line-of-credit through January 2011. The credit facility was not a source of liquidity for ongoing operations. It was available as an additional funding source in the event of a natural catastrophe.

The Board's financing cost may be impacted by short-term and long-term debt ratings assigned by independent rating agencies. During the fiscal year ended June 30, 2011, the Board's revenue bonds were rated at AA+ by both Standard & Poor's and Fitch. In issuing bond ratings, agencies typically evaluate financial operations, rate-setting practices, and debt ratios. Higher ratings aid in securing favorable borrowing rates, which results in lower interest costs.

Debt ratings are based, in significant part, on the Board's performance as measured by certain credit measures. In order to maintain its strong credit ratings, the Board has adopted certain financial goals. Such goals provide a signal to the Board as to the adequacy of rates for funding ongoing cash flows from operations. One such goal is a cash goal of 7 percent of in-lieu-of-tax payments, purchased power, and operating and maintenance expenses. The cash goal was increased to 10 percent of the above mentioned expenditures in fiscal year 2011. That goal was met every month of the fiscal year 2011. That percentage was 14.5 percent as of June 30, 2011, and 10.8 percent as of June 30, 2010. The Board also has a goal of maintaining a debt coverage ratio of at least 2 to 1. The Board's debt coverage ratio for the 12 months ended June 30, 2011, was 3.17 to 1. The Board continues to exceed its goals. The outlook on all debt ratings is stable as of June 30, 2011.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)




### Operations

**Summary Revenue & Expense Data**
**($000 omitted)**

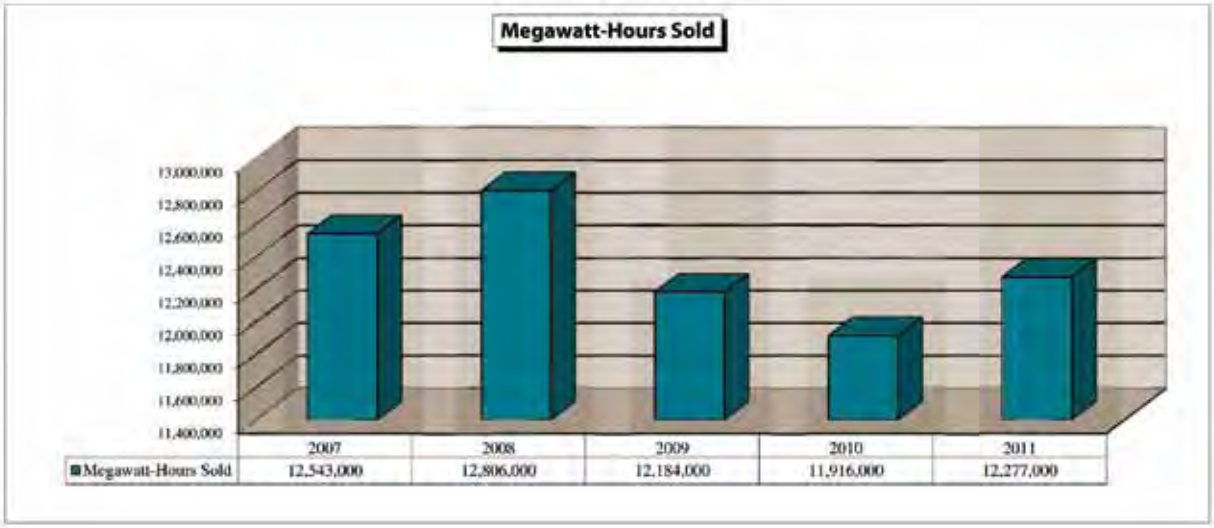
| | Year Ended June 30, 2011 | 2010 | Net Asset Effect | Year Ended June 30, 2009 | Net Asset Effect |
|---|---|---|---|---|---|
| Operating Revenues | $1,199,609 | $1,063,155 | $ 136,454 | $1,146,747 | $ (83,592) |
| Purchased Power | 927,065 | 816,152 | (110,913) | 915,005 | 98,853 |
| Margin | 272,544 | 247,003 | 25,541 | 231,742 | 15,261 |
| Operating Expenses | 142,189 | 133,314 | (8,875) | 128,229 | (5,085) |
| Depreciation and Tax Equivalents | 75,115 | 72,840 | (2,275) | 70,055 | (2,785) |
| Interest Income | 513 | 1,328 | (815) | 7,721 | (6,393) |
| Interest Expense | 24,451 | 26,362 | 1,911 | 25,174 | (1,188) |
| Extraordinary Loss | 2,415 | 2,110 | (305) | - | (2,110) |
| Increase in Net Assets | $ 28,887 | $ 13,705 | $ 15,182 | $ 16,005 | $ (2,300) |

**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

## 2011 and 2010 Results of Operations

On April 1, 2011, the Tennessee Valley Authority ("TVA") implemented a new wholesale Time of Use rate structure. With the new structure, retail customers are billed under a seasonal rate structure. Retail and Wholesale billing units are misaligned due to timing of meter readings, which will impact retail revenue and wholesale power costs.

*Operating Revenues*. Operating revenues increased by $136.4 million, or 12.8 percent, when compared to 2010. Total electric sales were $1.2 billion for the period versus $1.0 billion in 2010. The average realized rate on electric sales was $.0961 per kilowatt-hour in 2011 compared to $.0877 per kilowatt-hour in 2010. The increase in average realized rates in 2011 is the impact of TVA rate adjustments for fuel costs and the rate structure change. Megawatt-hours sold in 2011 increased by 3.0 percent when compared to 2010. In October 2009, TVA increased wholesale rates by 9.0 percent, which increased retail rates by 7.2 percent. The wholesale rate increase and monthly Fuel Cost Adjustment ("FCA") were implemented as a pass-through to our retail customers. Since the increase in wholesale rates and fluctuations in the wholesale FCA were matched by corresponding adjustments in retail rates, there was no significant impact on NES net income. In addition, NES increased retail rates in October 2009 by 3.0 percent, which had a direct impact on NES net income. Weather plays an important part in determining revenue for any year. The impact of weather is reflected in the comparison of degree-days from one period to the next. Degree-days represent the difference between the weather's average daily temperatures minus 65 degrees. Temperatures above 65 degrees are considered cooling degree-days; temperatures below 65 degrees are considered heating degree-days. Total cooling degree-days were 2,069 in 2011 compared to 1,730 in 2010. Total heating degree-days were 3,665 in 2011 compared to 3,942 in 2010. Total heating and cooling degree-days were 5,734 in 2011 compared to 5,672 in 2010 or an increase of approximately 1.1 percent. Total average number of active year-to-date customers increased by 0.2 percent when compared to 2010. Revenue in Excess of Net Bills, (Late Charge) increased by $1.0 million, and Rentals and Electric Property (primarily pole attachments) increased $0.7 million.




*Non-operating Revenues*. Interest income was $0.5 million in 2011 compared to $1.3 million in 2010. The average rate of return on the General Fund was 0.2 percent in 2011 compared to 0.2 percent in 2010. The average monthly balance of the General Fund was $126.3 million in 2011 compared to $102.8 million in 2010, an increase of 22.9 percent. Interest income was less than the previous

**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

year due to the additional draw down of funds from the Construction Fund that were provided by the June 2008 bond issuance.

*Operating Expenses.* The Board purchases all of its power from TVA under an all-requirements contract that had an initial term of 20 years. Beginning on December 19, 1989, and on each subsequent anniversary thereafter, the contract is automatically extended for an additional one-year period. The contract is subject to earlier termination by either party on not less than 10 years' prior written notice. Purchased power was $927.1 million for the period compared to $816.2 million in 2010. The average realized rate on purchased power was $.070 per kilowatt-hour in 2011 compared to $.065 per kilowatt-hour in 2010. This increase is due to the pass-through of the FCA and the rate structure change in April 2011. Megawatt-hours purchased were 13.2 million in 2011 compared to 12.5 million in 2010.

Distribution expenses for the period were $55.7 million compared to $43.6 million in 2010. This is an increase of $12.1 million or 27.8 percent. The change is primarily attributable to increases in miscellaneous expenses, $5.8 million; operation and maintenance of overhead lines, $2.4 million; storms, $2.1 million; supervision and engineering, $1.5 million; operation and maintenance of street lights, $0.9 million; and operation and maintenance of underground lines, $0.6 million, offset by a decrease in tree-trimming, $1.5 million.

Customer Accounts expense and Customer Service and Information expenses combined were $22.4 million for the period compared to $20.2 million in 2010 or an increase of $2.2 million or 10.9 percent. This is primarily the result of an increase in the uncollectible accounts accrual of $1.5 million; customer orders and service expenses of $0.7 million; data processing of $0.3 million, offset by a decrease in customer records and collection of $0.2 million.

Administrative and General (A&G) expenses were $62.8 million for the period compared to $68.3 million in 2010. This was a decrease of $5.5 million or 8.0 percent. The decrease is primarily the result of a decrease in employee health insurance, $4.2 million; employee pensions, $1.0 million; outside services employed, $0.6 million; and injuries and damages, $0.4 million, offset by an increase in data processing, $0.5 million; and administrative and general salaries, $0.1 million.

Depreciation and Tax Equivalents were $47.5 million and $27.6 million compared to $46.0 million and $26.8 million for 2011 and 2010, respectively. The increase in depreciation was the result of increased investment in the utility plant. Tax equivalents consist primarily of payments in–lieu-of taxes to the Metropolitan Government and the surrounding counties. Such payments are calculated based on a prescribed formula that takes into consideration utility plant value and the average of the Board's last three years' operating margin. The increase in payments in-lieu-of taxes was the result of increases in tax rates coupled with increased investment in the utility plant.

*Extraordinary Loss.* NES experienced an extraordinary loss due to extensive flooding that impacted the Nashville area in May of 2010. An event is deemed extraordinary if it is both unusual in nature and infrequent in occurrence. The extraordinary loss recognized in 2011 was $2.4 million. It was made up of $1.9 million in expenditures and a reduction to the prior year receivable of $0.5 million. The extraordinary loss recognized in 2010 of $2.1 million was made up of $1.0 million in expenditures in excess of the estimated $5.3 million receivable from Federal Emergency Management Agency ("FEMA") and a $1.1 million impairment loss on capital assets.

**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

## 2010 and 2009 Results of Operations

*Operating Revenues.* Operating revenues decreased by $83.6 million, or 7.3 percent, when compared to 2009. Total electric sales were $1.0 billion in 2010 versus $1.1 billion in 2009. The average realized rate on electric sales was $.0877 per kilowatt-hour in 2010 compared to $.0926 per kilowatt-hour in 2009. The decrease in average realized rates in 2010 is the impact of TVA rate adjustments for fuel offset by the wholesale rate increase that was effective in October 2009. Megawatt-hours sold in 2010 decreased by 2.2 percent when compared to 2009. In addition, NES increased retail rates 3.0 percent in October 2009, which did have a direct impact on NES net income. Weather plays an important part in determining revenue for any year. The impact of weather is reflected in the comparison of degree-days from one period to the next. Degree-days represent the difference between the weather's average daily temperatures minus 65 degrees. Temperatures above 65 degrees are considered cooling degree-days; temperatures below 65 degrees are considered heating degree-days. Total cooling degree-days were 1,730 in 2010 compared to 1,838 in 2009. Total heating degree-days were 3,942 in 2010 compared to 3,614 in 2009. Total heating and cooling degree-days were 5,672 in 2010 compared to 5,452 in 2009 or an increase of approximately 4.0 percent. Total average number of active year-to-date customers increased by .6 percent when compared to 2009. Revenue in Excess of Net Bills (Late Charge) increased by $0.4 million, and Rentals of Electric Property (primarily pole attachments) increased by $0.5 million.

*Non-operating Revenues.* Interest Income was $1.3 million compared to $7.7 million in 2009. The average rate of return on the General Fund was .20 percent in 2010 compared to .75 percent in 2009. The average monthly balance of the General Fund was $102.8 million in 2010 compared to $98.0 million in 2009, an increase of 5.0 percent. Interest income was less in 2010 due to the additional draw-down of funds in the Construction Fund that were provided by the June 2008 bond issuance.

*Operating Expenses.* Purchased power was $816.2 million for 2010 compared to $915.0 million for 2009. The average realized rate on purchased power was $.065 per kilowatt-hour in 2010 compared to $.079 per kilowatt-hour in 2009. This decrease is due to the pass-through of the FCA offset by the impact of TVA wholesale rate increases in October 2009. Megawatt-hours purchased were 12.5 million in 2010 compared to 12.6 million in 2009. Line losses were 4.33 percent in 2010 compared to 2.78 percent in 2009, or an increase of 55.7 percent. The increase in line losses for 2010 were primarily the result of a record winter peak and the impact of the May flood.

Distribution expenses for the period were $43.6 million in 2010 compared to $49.7 million in 2009. This is a decrease of $6.1 million or 12.3 percent. The change is primarily attributable to decreases in tree-trimming, $3.5 million; miscellaneous expenses, $1.4 million; operation and maintenance of overhead lines, $1.1 million; meters, $0.6 million; and storms, $0.5 million, offset by increases in operation and maintenance of station equipment, $0.4 million; line transformers, $0.1 million; supervision and engineering, $0.1 million; emergency service, $0.1 million; and load dispatching, $0.1 million.

Customer Accounts expense and Customer Service and Information expense combined were $21.4 million for 2010 compared to $22.7 million in 2009 or a decrease of $1.3 million or 5.7 percent. This is primarily the result of a decrease in the uncollectible accounts accrual of $1.2 million; customer orders and service expenses of $0.1 million; data processing of $0.1 million, offset by an increase in customer records and collection of $0.1 million.

**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

Administrative and General (A&G) expenses were $68.3 million in 2010 compared to $55.8 million in 2009. This was an increase of $12.5 million or 22.4 percent. The increase is primarily the result of an increase in employee pensions of $6.3 million; employee health insurance of $4.4 million; injuries and damages of $1.1 million; miscellaneous general, $0.6 million; and outside services employed of $0.4 million, offset by a decrease in data processing of $0.2 million.

Depreciation and Tax Equivalents were $46.0 million and $26.8 million compared to $44.0 million and $26.0 million for 2010 and 2009, respectively. The increase in depreciation was the result of increased investment in the utility plant.

*Extraordinary Loss*. The Board experienced an extraordinary loss in May of 2010 from the flood. An event is deemed extraordinary if it is both unusual in nature and infrequent in occurrence. The extraordinary loss in 2010 of $2.1 million was made up of $1.0 million in expenditures in excess of the estimated $5.3 million receivable from insurance and government disaster assistance grants and a $1.1 million impairment loss on capital assets.

The following table shows the composition of the operating expenses of the Board by major classification of expense for the last three years:

**Major Classifications of Expense ($000 omitted)**

| Description | Fiscal 2011 | Fiscal 2010 | Increase (Decrease) | Fiscal 2009 | Increase (Decrease) |
|---|---|---|---|---|---|
| Labor | $ 58,338 | $ 48,547 | 20.2% | $ 49,859 | (2.6%) |
| Benefits | 39,143 | 46,761 | (16.3%) | 33,932 | 37.8% |
| Tree-trimming | 8,873 | 8,393 | 5.7% | 10,655 | (21.2%) |
| Outside Services | 8,290 | 8,579 | 3.4% | 7,879 | 8.9% |
| Materials | 1,722 | 3,240 | (46.9%) | 4,141 | (21.8%) |
| Transportation | 4,412 | 4,324 | 2.0% | 4,099 | 5.5% |
| Accrual for Uncollectible Accounts | 5,234 | 3,750 | 39.6% | 5,012 | (25.2%) |
| Postage | 1,323 | 1,539 | (14.0%) | 1,477 | 4.2% |
| Security/Police | 1,186 | 1,128 | 5.1% | 1,097 | 2.8% |
| Rentals | 992 | 738 | (34.4%) | 1,100 | (32.9%) |
| Professional Fees | 1,132 | 1,708 | (33.7%) | 1,484 | 15.1% |
| Insurance Premiums | 664 | 688 | 3.5% | 672 | 2.4% |
| Other | 10,880 | 3,879 | 180.5% | 6,822 | (43.1%) |
| | $142,189 | $133,274 | 6.7% | $128,229 | 4.0% |

The Board's total operating expenses increased 6.7 percent from June 30, 2010, to June 30, 2011. Labor for fiscal year 2011 totaled $58.3 million, which represents an increase from fiscal year 2010 due to cost-of-living adjustment, step increases and changes in allocation between O&M and Capital. This allocation change was a result of an assessment of labor in fiscal year 2010. The labor expense for fiscal 2010 was offset by $4.8 million of Federal Disaster assistance. Benefits decreased due to actuarial valuation results for Retirement and Survivors and Other Post-Employment

**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

Benefits. This was offset by an increase in Medical expenses. Tree-trimming decreased because of a full year of the four-year trim cycle was experienced. The Outside Services increased due to additional contracts resulting from the May 2010 flood. Material costs were less than in 2009 due to salvageable material, related to the referenced flood, placed back into inventory. Transportation costs are more than in 2009 due to increased storm restoration. The Accrual for Uncollectible Accounts increased due to escalated write-offs. Professional Fees decreased due to fewer litigation fees needed. The Other category contains a wide array of smaller accounts.

The Board's total operating expenses increased 4.0 percent from June 30, 2009, to June 30, 2010. The labor expense for fiscal 2010 was offset by $4.8 million of Federal Disaster assistance that was accrued, resulting in a net decrease in total labor costs. Benefits increased due to the increase in funding of Retirement and Survivors and Other Post-Employment Benefits determined by the actuarial valuations. The increase in the actuarial valuations was a direct result of the impact of the investment market. Tree-trimming decreased due to efficiencies gained over the life of our vegetation management program and adoption of our four-year trim cycle. The increase in Outside Services is primarily due to additional contract pole inspections. Material costs were less than in 2009 due to a new requisitioning process. Transportation costs increased due to the cost of maintaining and operating vehicles. The Accrual for Uncollectable Accounts decreased due to fewer write-offs. Professional fees increased primarily due to additional legal fees.

**Capital Assets and Debt Administration**

The Board's transmission and distribution facilities serve more than 700 square miles and include the Metropolitan Government of Nashville and Davidson County, Tennessee. The Board also serves portions of the adjacent counties of Cheatham, Rutherford, Robertson, Sumner, Wilson, and Williamson. Such facilities require significant annual capital and maintenance expenditures. The Board's target is to have the capital expenditures funded equally from cash flow from operations and proceeds from tax-exempt bonds. The Board's investment in utility plant at June 30, 2011, was $842.4 million compared to $819.3 million at June 30, 2010. Major projects during fiscal year 2011 included approximately $11.3 million for the Music City Center project; substation improvement projects at Watkins Park and Pennington Bend, $3.1 million; pole replacements at Radnor substation and various other locations, $2.0 million; replace substation equipment, $1.9 million; and breaker upgrades at Battlefield, Finn Street and Edgehill substations, $0.9 million.

The Board has outstanding bonds payable of $482.1 million at June 30, 2011, compared to $502.0 million at June 30, 2010. This decrease is due primarily to the current portion of long-term debt maturing in 2011. The total outstanding bonds payable as of June 30, 2009, was $520.9 million. The Board plans to issue additional revenue bonds in November 2011. More detailed information about the Board's debt can be found in the financial statements.

Respectfully submitted,

Teresa Broyles-Aplin
Vice President and Chief Financial Officer

**ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY**

**STATEMENTS OF NET ASSETS ($000 OMITTED)**
**JUNE 30, 2011 AND 2010**

| | 2011 | 2010 |
|---|---|---|
| **ASSETS** | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 159,380 | $ 106,097 |
| Customer and other accounts receivable, less allowance for doubtful accounts of $1,170 and $822, respectively | 148,276 | 137,290 |
| Accrued interest receivable | 11 | 460 |
| Materials and supplies | 19,884 | 20,015 |
| Other current assets | 2,190 | 2,094 |
| TOTAL CURRENT ASSETS | 329,741 | 265,956 |
| INVESTMENT OF RESTRICTED FUNDS: | | |
| Cash and cash equivalents | 51,524 | 3,355 |
| Other investments | 3,737 | 87,982 |
| TOTAL INVESTMENT OF RESTRICTED FUNDS | 55,261 | 91,337 |
| UTILITY PLANT: | | |
| Electric plant, at cost | 1,366,207 | 1,322,130 |
| Less: Accumulated depreciation | (523,823) | (502,795) |
| TOTAL UTILITY PLANT, NET | 842,384 | 819,335 |
| ENERGY CONSERVATION PROGRAMS' NOTES RECEIVABLE | 884 | 227 |
| UNAMORTIZED BOND ISSUANCE COSTS | 2,258 | 2,496 |
| OTHER NON-CURRENT ASSETS | 308 | 335 |
| TOTAL ASSETS | 1,230,836 | 1,179,686 |

See notes to financial statements.

**ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY**

**STATEMENTS OF NET ASSETS ($000 OMITTED)**
**JUNE 30, 2011 AND 2010 (continued)**

| | 2011 | 2010 |
|---|---|---|
| **LIABILITIES** | | |
| CURRENT LIABILITIES: | | |
| Accounts payable for purchased power | 155,802 | 121,763 |
| Other accounts payable and accrued expenses | 29,463 | 34,191 |
| Customer deposits | 12,948 | 12,600 |
| TOTAL CURRENT LIABILITIES | 198,213 | 168,554 |
| CURRENT LIABILITIES PAYABLE FROM RESTRICTED ASSETS: | | |
| Construction contracts payable | 4,349 | 742 |
| Accrued interest payable | 2,726 | 2,778 |
| Current portion of long-term debt | 15,038 | 14,830 |
| TOTAL CURRENT LIABILITIES PAYABLE FROM RESTRICTED ASSETS | 22,113 | 18,350 |
| LONG-TERM DEBT, LESS CURRENT PORTION | 467,103 | 487,142 |
| OTHER NON-CURRENT LIABILITIES: | | |
| Payable to TVA—energy conservation programs | 785 | 227 |
| Other | 11,926 | 3,604 |
| TOTAL OTHER NON-CURRENT LIABILITIES | 12,711 | 3,831 |
| COMMITMENTS AND CONTINGENCIES | | |
| TOTAL LIABILITIES | 700,140 | 677,877 |
| **NET ASSETS** | | |
| Invested in utility plant, net of related debt | 358,152 | 355,501 |
| Restricted | 52,536 | 52,177 |
| Unrestricted | 120,008 | 94,131 |
| TOTAL NET ASSETS | $ 530,696 | $ 501,809 |

See notes to financial statements.

**ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY**

**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS ($000 OMITTED)**
**YEARS ENDED JUNE 30, 2011 AND 2010**

| | 2011 | 2010 |
|---|---|---|
| OPERATING REVENUES: | | |
| Residential | $ 507,787 | $ 446,321 |
| Commercial and industrial | 656,448 | 584,369 |
| Street and highway lighting | 16,066 | 14,583 |
| Other | 19,308 | 17,882 |
| Total operating revenues | 1,199,609 | 1,063,155 |
| PURCHASED POWER | 927,065 | 816,152 |
| MARGIN | 272,544 | 247,003 |
| OPERATING EXPENSES: | | |
| Distribution | 55,674 | 43,595 |
| Customer accounts | 22,446 | 20,216 |
| Customer service and information | 1,282 | 1,240 |
| Administrative and general | 62,787 | 68,263 |
| Tax equivalents | 27,592 | 26,806 |
| Depreciation | 47,523 | 46,034 |
| Total operating expenses | 217,304 | 206,154 |
| Operating income | 55,240 | 40,849 |
| NON-OPERATING REVENUE (EXPENSE): | | |
| Interest income | 513 | 1,328 |
| Interest expense | (24,451) | (26,362) |
| Total non-operating expense | (23,938) | (25,034) |
| EXTRAORDINARY LOSS – FLOOD | (2,415) | (2,110) |
| NET INCREASE IN NET ASSETS | 28,887 | 13,705 |
| NET ASSETS, beginning of year | 501,809 | 488,104 |
| NET ASSETS, end of year | $ 530,696 | $ 501,809 |

See notes to financial statements.

**ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY**

**STATEMENTS OF CASH FLOWS ($000 OMITTED)**
**YEARS ENDED JUNE 30, 2011 AND 2010**

| | 2011 | 2010 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Receipts from customers | $ 1,188,306 | $ 1,045,483 |
| Payments to suppliers for goods and services | (983,552) | (874,912) |
| Payments to employees | (48,972) | (53,473) |
| Payments for tax equivalents | (26,969) | (26,267) |
| Net cash provided by operating activities | 128,813 | 90,831 |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES: | | |
| Acquisition and construction of utility plant | (59,204) | (62,713) |
| Utility plant removal costs | (10,641) | (7,183) |
| Salvage received from utility plant retirements | 1,373 | 1,237 |
| Principal payments on revenue bonds | (14,830) | (14,881) |
| Interest payments on revenue bonds | (29,266) | (29,117) |
| Net cash used in capital and related financing activities | (112,568) | (112,657) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchases of investment securities | (53,778) | (57,717) |
| Proceeds from sales and maturities of investment securities | 138,023 | 92,155 |
| Interest on investments | 962 | 1,542 |
| Net cash provided by investing activities | 85,207 | 35,980 |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 101,452 | 14,154 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR | 109,452 | 95,298 |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | $ 210,904 | $ 109,452 |

See notes to financial statements.

**ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY**

**STATEMENTS OF CASH FLOWS ($000 OMITTED)**
**YEARS ENDED JUNE 30, 2011 AND 2010 (continued)**

| | 2011 | 2010 |
|---|---|---|
| Reconciliation of operating income to net cash provided by operating activities: | | |
| Operating income | $ 55,240 | $ 40,849 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | |
| Depreciation | 49,030 | 47,728 |
| Changes in assets and liabilities: | | |
| Increase in customer and other accounts receivable | (10,986) | (18,151) |
| Decrease (increase) in materials and supplies | 131 | (1,636) |
| Increase in other current assets | (96) | (170) |
| (Increase) decrease in energy conservation programs' notes receivable | (657) | 139 |
| Decrease in other non-current assets | 27 | 6 |
| Increase in accounts payable for purchased power | 34,039 | 14,153 |
| (Decrease) increase in other accounts payable and accrued expenses | (4,728) | 9,194 |
| Increase in customer deposits | 348 | 340 |
| Increase (decrease) in payable to TVA–energy conservation programs | 558 | (139) |
| Increase in other non-current liabilities | 8,322 | 628 |
| Extraordinary loss–flood | (2,415) | (2,110) |
| Net cash provided by operating activities | $ 128,813 | $ 90,831 |

NON-CASH CAPITAL AND RELATED FINANCING ACTIVITIES:

Accounts payable associated with the acquisition and construction of utility plant was $3.6 million in 2011 and such amounts were insignificant for 2010.

During 2011 and 2010, NES charged $18.7 million and $7.8 million, respectively, to accumulated depreciation representing the cost of retired utility plant.

During 2011 and 2010, $651 thousand and $675 thousand respectively, were charged to interest expense for amortization of bond premiums. Also, $553 thousand and $588 thousand were charged as amortization of the bond-issuance costs in 2011 and 2010, respectively.

See notes to financial statements.

**ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY**
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2011 AND 2010

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Electric Power Board of the Metropolitan Government of Nashville and Davidson County (the "Board") was established in 1939 when the City of Nashville purchased certain properties of the Tennessee Electric Power Company for the purpose of exercising control and jurisdiction over the electric distribution system. In conducting the operations of the electric distribution system, the Board does business as Nashville Electric Service ("NES"). NES is a component unit of The Metropolitan Government of Nashville and Davidson County, Tennessee (the "Metropolitan Government"), and is operated by a five-member board appointed by the Mayor and confirmed by the Council of the Metropolitan Government. Members of NES serve five-year staggered terms without compensation. In accordance with the Charter of the Metropolitan Government, NES exercises exclusive control and management, except NES must obtain the approval of the Council before issuing revenue bonds. The Metropolitan Government does not assume liability for the financial obligations of NES. In addition, the assets of NES cannot be encumbered to satisfy obligations of the Metropolitan Government. NES appoints a chief executive officer, who is charged with the responsibility for the day-to-day operations, including hiring of employees.

The financial statements of NES have been prepared in conformity with accounting principles generally accepted in the United States of America. NES maintains its accounts in accordance with the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission on the accrual basis of accounting. NES is not subject to the jurisdiction of federal or state energy regulatory commissions.

Under Governmental Accounting Standards Board ("GASB") Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, NES has elected to apply Financial Accounting Standards Board ("FASB") Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements.

The significant accounting policies followed by NES are outlined below.

***Estimates*** used in the preparation of financial statements are based on management's best judgments. The most significant estimates relate to allowance for uncollectible accounts receivable, useful lives of capital assets, employee benefit plan obligations, accrued power receivable and payable, unbilled receivables, and unreported medical claims. These estimates may be adjusted as more current information becomes available.

***For purposes of the statements of cash flows,*** cash and cash equivalents include cash, commercial paper, U.S. Treasury Bills and certificates of deposit with an original maturity of three months or less.

***Restricted Assets*** of NES represent bond proceeds designated for construction and other monies required to be restricted for debt service.

**ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY**
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2011 AND 2010

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

***Utility Plant*** is stated at original cost. Such cost includes applicable general and administrative costs and payroll and related costs such as pensions, taxes and other fringe benefits related to plant construction. Interest cost incurred during the period of construction of certain plant is capitalized. Capitalized interest was $479 thousand in 2011 and $587 thousand in 2010.

When plant assets are disposed of at salvage value, NES charges the amount to accumulated depreciation. Costs of depreciable retired utility plant, plus removal costs, less salvage, are charged to accumulated depreciation.

Depreciation is provided at rates which are designed to amortize the cost of depreciable plant over the estimated useful lives ranging from 7 to 50 years. The composite straight-line rates expressed as a percentage of average depreciable plant were as follows for June 30, 2011 and 2010:

| | 2011 | 2010 |
|---|---|---|
| Distribution plant, 18.2 to 40 years | 3.5% | 3.6% |
| Structure and improvements, 40 to 50 years | 2.1% | 2.1% |
| Office furniture and equipment, 7.1 to 16.7 years | 13.6% | 13.7% |
| Transportation equipment, 8 to 10 years | 5.9% | 6.1% |
| Other equipment, 8 to 33.3 years | 5.3% | 6.0% |

Maintenance and repairs, including the cost of renewals of minor items of property, are charged to maintenance expense accounts. Replacements of property are charged to utility plant accounts.

***Investments and Cash Equivalents*** (including restricted assets) consist primarily of short-term U.S. Government securities or mortgage-backed securities from agencies chartered by Congress, and certificates of deposit. In accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools*, investments are reflected at their fair value except those investments that have a remaining maturity at the time of purchase of one year or less and certificates of deposit, which are reflected at cost.

***Materials and Supplies*** are stated at the moving weighted average cost which approximates actual cost.

***Unamortized Bond Issuance*** costs incurred in connection with the issuance of bonds are being amortized over the respective lives of the bond issues using the effective interest method.

***Compensated Absences*** represent the liability for employees' accumulated vacation days. The general policy of NES permits the accumulation, within certain limitations, of unused vacation days. This amount is included in other accounts payable and accrued expenses in the Statement of Net Assets.

**ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY**
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2011 AND 2010

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

***Revenues*** are recognized from meters read on a monthly cycle 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.

NES purchases electric power from the Tennessee Valley Authority ("TVA"). On April 1, 2011, TVA implemented a new wholesale Time of Use rate structure. With the new structure, retail customers are billed under a seasonal rate structure. Retail and Wholesale billing units are misaligned due to timing of meter readings, which will impact retail revenue and wholesale power costs. This is a significant change that results in NES now having margin risk. Prior to this, the cost of purchased power was calculated based upon these retail billing units adjusted for estimated line losses. NES accrues for unbilled purchased power based on retail billing units.

***Asset Retirement Obligations*** are periodically reviewed and management has concluded that, at present, NES does not have any such asset retirement obligations.

***Operating and Non-operating Revenues and Expenses*** - Operating revenues include the sale of power and rental of electric property. Operating expenses include direct and indirect costs to operate and maintain the electric distribution system, including purchased power, fuel, depreciation, customer accounts, tax equivalents, and general and administrative costs. Non-operating revenues and expenses consist of interest income and expense.

***Income Taxes*** - NES is not subject to federal or state income taxes. While NES is not subject to property tax, NES pays tax equivalents in-lieu-of taxes to the Metropolitan Government and surrounding counties. Tax equivalents consist primarily of payments in-lieu-of taxes to the Metropolitan Government and the surrounding counties. Such payments are calculated based on a prescribed formula that takes into consideration utility plant value and the average of the Board's last three years' operating margin.

**ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY**
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2011 AND 2010

## 2. UTILITY PLANT AND ACCUMULATED DEPRECIATION

Utility plant activity for the years ended June 30, 2011 and 2010, was as follows ($000 omitted):

| | Balance June 30, 2010 | Additions | Transfers & Retirements | Balance June 30, 2011 |
|---|---|---|---|---|
| Distribution plant | $ 1,124,772 | $ 53,976 | $ (14,030) | $ 1,164,718 |
| Land and land rights | 1,139 | - | - | 1,139 |
| Structures and improvements | 44,984 | 1,626 | - | 46,610 |
| Office furniture and equipment | 38,219 | 2,886 | (362) | 40,743 |
| Transportation equipment | 7,244 | 367 | (413) | 7,198 |
| Other equipment | 36,446 | 5,998 | (3,931) | 38,513 |
| Construction work-in-progress (a) | 69,326 | - | (2,040) | 67,286 |
| | $ 1,322,130 | $ 64,853 | $ (20,776) | $ 1,366,207 |

| | Balance June 30, 2009 | Additions | Transfers & Retirements | Balance June 30, 2010 |
|---|---|---|---|---|
| Distribution plant | $ 1,084,476 | $ 47,133 | $ (6,837) | $ 1,124,772 |
| Land and land rights | 1,139 | - | - | 1,139 |
| Structures and improvements | 45,133 | - | (149) | 44,984 |
| Office furniture and equipment | 37,887 | 1,077 | (745) | 38,219 |
| Transportation equipment | 7,331 | 41 | (128) | 7,244 |
| Other equipment | 37,067 | 714 | (1,335) | 36,446 |
| Construction work-in-progress (a) | 54,211 | 15,115 | - | 69,326 |
| | $ 1,267,244 | $ 64,080 | $ (9,194) | $ 1,322,130 |

(a) Represents the net activity to the construction work-in-progress account after transfers to plant accounts.

**ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY**
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2011 AND 2010

## 2. UTILITY PLANT AND ACCUMULATED DEPRECIATION (continued)

The related activity for accumulated depreciation for the years ended June 30, 2011 and 2010, was as follows ($000 omitted):

| | Balance June 30, 2010 | Provision | Original Cost | Cost of Removal | Salvage | Balance June 30, 2011 |
|---|---|---|---|---|---|---|
| Distribution plant | $ 422,779 | $ 40,297 | $ (14,027) | $ (10,641) | $ 1,022 | $ 439,430 |
| Structures and improvements | 15,946 | 939 | - | - | - | 16,885 |
| Office furniture and equipment | 34,967 | 5,371 | (362) | - | 1 | 39,977 |
| Transportation equipment | 2,383 | 426 | (397) | - | 353 | 2,765 |
| Other equipment | 26,720 | 1,997 | (3,948) | - | (3) | 24,766 |
| | $ 502,795 | $ 49,030 | $ (18,734) | $ (10,641) | $ 1,373 | $ 523,823 |

| | Balance June 30, 2009 | Provision | Original Cost | Cost of Removal | Salvage | Balance June 30, 2010 |
|---|---|---|---|---|---|---|
| Distribution plant | $ 396,661 | $ 38,899 | $ (6,775) | $ (7,183) | $ 1,177 | $ 422,779 |
| Structures and improvements | 15,011 | 935 | - | - | - | 15,946 |
| Office furniture and equipment | 30,500 | 5,209 | (744) | - | 2 | 34,967 |
| Transportation equipment | 1,891 | 446 | - | - | 46 | 2,383 |
| Other equipment | 24,776 | 2,239 | (307) | - | 12 | 26,720 |
| | $ 468,839 | $ 47,728 | $ (7,826) | $ (7,183) | $ 1,237 | $ 502,795 |

Depreciation is either capitalized as a cost of utility plant or reported as depreciation expense in the statement of revenues, expenses and changes in net assets.

**ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY**
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2011 AND 2010

## 3. CASH AND INVESTMENTS

Cash and investments consist of the following ($000 omitted):

**2011**

| | Cash | Bond Funds | Special Construction | Total | Weighted Average Maturity (Years) |
|---|---|---|---|---|---|
| Cash and cash equivalents | $ 159,380 | $ 51,524 | $ - | $ 210,904 | - |
| Securities from Agencies Chartered by Congress | - | 3,737 | - | 3,737 | - |
| | $ 159,380 | $ 55,261 | $ - | $ 214,641 | - |

**2010**

| | Cash | Bond Funds | Special Construction | Total | Weighted Average Maturity (Years) |
|---|---|---|---|---|---|
| Cash and cash equivalents | $ 106,097 | $ 474 | $ 2,881 | $ 109,452 | - |
| U.S. Treasury Investments | - | 25,638 | - | 25,638 | 0.07 |
| Securities from Agencies Chartered by Congress | - | 28,842 | 33,502 | 62,344 | 0.68 |
| | $ 106,097 | $ 54,954 | $ 36,383 | $ 197,434 | 0.70 |

There were no investments reported at fair value in U.S. Treasury Investments, Securities from Agencies Chartered by Congress, commercial paper and certificates of deposit held at June 30, 2011. Investments of $56.3 million in U.S. Treasury Investments and Securities from Agencies Chartered by Congress were reported at fair value as of June 30, 2010. Investments of $3.7 million and $31.7 million at June 30, 2011 and 2010, respectively, were held in U.S. Treasury investments, Securities from Agencies Chartered by Congress, commercial paper and certificates of deposit are reported at cost.

**ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY**
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2011 AND 2010

**3. CASH AND INVESTMENTS (continued)**

The net decrease in the fair value of investments during fiscal year 2011 was $1.2 million. This amount takes into account all changes in fair value (including purchases and sales) that occurred during the year.

***Custodial Credit Risk*** – As of June 30, 2011 and 2010, NES' cash and cash equivalents held by financial institutions was $210.9 million and $109.5 million, respectively. Bank balances for such accounts totaled $109.9 million and $106.4 million, respectively. Deposits in financial institutions are required by State of Tennessee ("State") statute to be secured and collateralized by the institutions. The collateral must meet certain requirements and have a total minimum market value of 105 percent of the value of the deposits placed in the institutions less the amount protected by federal depository insurance. Collateral requirements are not applicable for financial institutions that participate in the State's collateral pool. As of June 30, 2011 and 2010, all of NES' deposits were held by financial institutions, which participate in the bank collateral pool administered by the State Treasurer. Participating banks determine the aggregated balance of their public-fund accounts for the Metropolitan Government. The amount of collateral required to secure these public deposits is a certain percentage set by the State, depending on the financial institution, and must be at least that percentage of the average daily balance of public deposits held. Collected securities required to be pledged by the participating banks to protect their public-fund accounts are pledged to the State Treasurer on behalf of the bank collateral pool. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement, public-fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure.

***Credit Risk*** – NES is authorized to invest in obligations of the U.S. Treasury and U.S. governmental agencies, Securities from Agencies Chartered by Congress, certificates of deposit, commercial paper rated A1 or equivalent and bonds of the State of Tennessee. Each of these investments is registered or held by NES or its agent in NES' name.

***Concentration of Credit Risk*** – NES has a policy prohibiting investment of greater than $5 million or 20 percent of the total investment portfolio in any one issue, except for the U.S. Government or any of its agencies. In 2011, 100 percent of NES' investments are in Securities from Agencies Chartered by Congress. In 2010, 71.0 percent of NES' investments are in Securities from Agencies Chartered by Congress.

***Interest Rate Risk*** – NES restricts its investments to maturities less than two years from the date of settlement as a means of managing exposure to fair value losses arising from changes in interest rates.

**ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY**
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2011 AND 2010

## 4. LONG-TERM DEBT

Long-term debt for the year ended June 30, 2011, is as follows ($000 omitted):

| | Balance June 30, 2010 | Deductions/ Repayments | Additions/ Amortization/ Accretion | Balance June 30, 2011 |
|---|---|---|---|---|
| Electric System Revenue Bonds, 1996 Series A, bear interest at rates from 5.5% to 6%, maturing through May 15, 2013, interest paid semiannually. | $ 29,828 | $ (5,510) | $ (5,949) | $ 18,369 |
| Electric System Revenue Bonds, 1998 Series A, bear interest at rates from 5.125% to 5.40%, maturing through May 15, 2023, interest paid semiannually. | 23,361 | - | 1,283 | 24,644 |
| Electric System Revenue Bonds, 1998 Series B, bear interest at rates from 4.75% to 5.50%, maturing through May 15, 2017, interest paid semiannually. | 33,281 | - | 61 | 33,342 |
| Electric System Revenue Bonds, 2001 Series A, bear interest at rates from 4.50% to 5.125%, maturing through May 15, 2017, interest paid semiannually. | 102,937 | (2,060) | 22 | 100,899 |
| Electric System Revenue Bonds, 2001 Series B, bear interest at 5.50%, maturing through May 15, 2014, interest paid semiannually. | 18,540 | - | (31) | 18,509 |
| Electric System Revenue Bonds, 2004 Series A, bear interest at rates from 4.50% to 5.00%, maturing through May 15, 2029, interest paid semiannually. | 109,379 | - | 4 | 109,383 |
| Electric System Revenue Bonds, 2008 Series A, bear interest at rates from 3.25% to 5.00%, maturing through May 15, 2033, interest paid semiannually. | 106,690 | (2,770) | (200) | 103,720 |
| Electric System Revenue Bonds, 2008 Series B, bear interest at rates from 3.25% to 5.00%, maturing through May 15, 2023, interest paid semiannually. | 77,956 | (4,490) | (191) | 73,275 |
| | 501,972 | $ (14,830) | $ (5,001) | 482,141 |
| Less current portion of long-term debt | (14,830) | | | (15,038) |
| | $ 487,142 | | | $ 467,103 |

**ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY**
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2011 AND 2010

**4. LONG-TERM DEBT (continued)**

Long-term debt for the year ended June 30, 2010, is as follows ($000 omitted):

| | Balance June 30, 2009 | Deductions/ Repayments | Additions/ Amortization/ Accretion | Balance June 30, 2010 |
|---|---|---|---|---|
| Electric System Revenue Bonds, 1996 Series A, bear interest at rates from 5.5% to 6%, maturing through May 15, 2013, interest paid semiannually. | $ 40,642 | $ (5,881) | $ (4,933) | $ 29,828 |
| Electric System Revenue Bonds, 1998 Series A, bear interest at rates from 5.125% to 5.40%, maturing through May 15, 2023, interest paid semiannually. | 22,149 | - | 1,212 | 23,361 |
| Electric System Revenue Bonds, 1998 Series B, bear interest at rates from 4.75% to 5.50%, maturing through May 15, 2017, interest paid semiannually. | 33,189 | - | 92 | 33,281 |
| Electric System Revenue Bonds, 2001 Series A, bear interest at rates from 4.50% to 5.125%, maturing through May 15, 2017, interest paid semiannually. | 104,890 | (1,970) | 17 | 102,937 |
| Electric System Revenue Bonds, 2001 Series B, bear interest at 5.50%, maturing through May 15, 2014, interest paid semiannually. | 18,565 | - | (25) | 18,540 |
| Electric System Revenue Bonds, 2004 Series A, bear interest at rates from 4.50% to 5.00%, maturing through May 15, 2029, interest paid semiannually. | 109,375 | - | 4 | 109,379 |
| Electric System Revenue Bonds, 2008 Series A, bear interest at rates from 3.25% to 5.00%, maturing through May 15, 2033, interest paid semiannually. | 109,589 | (2,685) | (214) | 106,690 |
| Electric System Revenue Bonds, 2008 Series B, bear interest at rates from 3.25% to 5.00%, maturing through May 15, 2023, interest paid semiannually. | 82,509 | (4,345) | (208) | 77,956 |
| | 520,908 | $ (14,881) | $ (4,055) | 501,972 |
| Less current portion of long-term debt | (14,881) | | | (14,830) |
| | $ 506,027 | | | $ 487,142 |

**ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY**
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2011 AND 2010

**4. LONG-TERM DEBT (continued)**

NES issues Revenue Bonds to provide funds primarily for capital improvements and for refundings of other bonds. All bond issues are secured by a pledge and lien on the net revenues of NES on parity with the pledge established by all bonds issued. Annual maturities on all long-term debt and related interest are as follows for each of the next five fiscal years and in five-year increments thereafter ($000 omitted):

| | Principal | Interest |
|---|---|---|
| 2012 | $ 20,960 | $ 23,134 |
| 2013 | 22,056 | 22,071 |
| 2014 | 23,020 | 21,041 |
| 2015 | 24,144 | 20,014 |
| 2016 | 25,190 | 19,032 |
| 2017-2021 | 140,511 | 76,057 |
| 2022-2026 | 141,005 | 41,168 |
| 2027-2031 | 71,181 | 12,074 |
| 2032-2033 | 14,074 | 1,027 |
| Total | $ 482,141 | $ 235,618 |

On June 27, 2008, the Board closed on the sale of the Metropolitan Government of Nashville and Davidson County, Tennessee, Electric System Revenue Bonds, 2008 Series A and B. The purpose of the 2008 Series A Bonds was to reimburse NES for a portion of the 2008 capital expenditures and to fund approximately 50 percent of NES' projected $219 million Capital Budget for the fiscal years ending June 30, 2009, through June 30, 2011. The remainder is being funded with operating revenues. The par amount of the 2008 Series A Bonds, $109.2 million, plus original issue premium, less underwriter discount, cost of issuance, and a deposit to the debt service reserve fund netted proceeds in the amount of $111.8 million of which $110 million was deposited into the Special Construction Fund, $1.6 million in the Debt Service Reserve Fund and $225 thousand into the General Fund. The 2008 Series B Bonds were being offered to refund $74.4 million aggregate principal amount of the 1998 Series A Bonds maturing May 15, 2015, 2016 and 2023, and to refund $13.2 million aggregate principal amount of 1998 Series B Bonds maturing on May 15, 2009, 2010 and 2011. During fiscal year 2011, NES drew down the remaining proceeds.

The following bond issue has been defeased through advanced refundings; therefore, the balances indicated, which are still outstanding at June 30, 2011, do not appear as liabilities on the Board's Statement of Net Assets:

| | Amounts Outstanding |
|---|---|
| 1998 Series A Bonds | $ 74,430,000 |

**ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY**
NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2011 AND 2010

**4. LONG-TERM DEBT (continued)**

NES had a $25 million unsecured line-of-credit through January 2011 and in 2010 to be used for purchased power in case of a natural disaster. Borrowings under this line of credit bore a negotiated interest rate. There were no borrowings under this line-of-credit at its expiration in January 2011 or at June 30, 2010.

**5. OTHER NON-CURRENT LIABILITIES**

NES' other non-current liabilities consist primarily of TVA energy conservation program loans and customer contributions. The following table shows the activity for the year ($000 omitted):

| June 30, 2010 | Repayments | Additions | June 30, 2011 |
|---|---|---|---|
| $ 3,831 | $ (7,545) | $ 16,425 | $ 12,711 |

| June 30, 2009 | Repayments | Additions | June 30, 2010 |
|---|---|---|---|
| $ 3,342 | $ (6,788) | $ 7,277 | $ 3,831 |

NES is a fiscal intermediary for the TVA energy conservation programs whereby loans are made to NES' customers to be used in connection with TVA's Residential Energy Services Program. Pursuant to the terms of an agreement with TVA, the energy conservation loans made to NES' customers are funded and guaranteed by TVA. Additionally, during 2011, NES received an advance payment of $10 million from TVA for the Smart Grid Pilot Program.

**6. PENSION PLAN**

The Nashville Electric Service Retirement Annuity and Survivors' Plan (the "Plan") is a single employer defined benefit pension plan administered by NES. The Plan provides retirement and survivors' benefits to members and beneficiaries. Cost-of-living adjustments are provided to members and beneficiaries annually. The Charter of the Metropolitan Government assigns the authority to establish and amend benefit provisions to NES. The Plan is not required to issue a separate financial report.

All full-time regular employees under age 65 are eligible to participate in the Plan. The vesting provision of the Plan provides for five-year cliff vesting. NES employees who retire at or after age 65 are entitled to annual retirement benefits payable monthly for life in an amount equal to 2 percent of final average compensation multiplied by years in the Plan not in excess of 35 years. Final average compensation is the average compensation in the 36 consecutive months in which compensation is highest. Unused sick leave may be used to increase credited service and benefit percentage under certain circumstances. Early retirement is an option beginning at age 55 with 15 years of credited service or at age 50 with 30 years of credited service with an actuarially-reduced monthly benefit.

If the participant has attained age 55, and his/her age plus service is 85 or greater, then there is no reduction for early receipt of the benefit. However, a participant cannot use accumulated sick

**ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY**
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**6. PENSION PLAN (continued)**

leave to increase effective age to meet the requirements for this unreduced benefit. For a participant with 25 or more years of service, the minimum pension benefit is $1,600 per month.

The contribution requirements of NES are established and may be amended by NES. The Plan is currently non-contributory. NES' practice is to typically fund at least the minimum contribution for a 30-year funding level. The current rate is 32.26 percent of annual covered payroll. NES contributed 100 percent of the required contribution for the Plan years 2011 and 2010.

The annual required contribution for the current year was determined as part of the April 1, 2010, actuarial valuation using the frozen initial liability method. The actuarial assumptions included (a) 8.0 percent investment rate of return and (b) projected salary increases of 4.5 percent. Both (a) and (b) included an inflation component. The assumptions include cost-of-living post-retirement benefit increases equal to 2 percent per year. The actuarial value of Plan assets is determined using techniques that smooth the effects of short-term volatility in the market value of investments over a three-year period. The unfunded actuarial accrued liability is being amortized over 30 years. The required schedule of funding progress below presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

A change was made in the plan funding method effective April 1, 2009, whereby the amortization period was reset to a 30-year period beginning April 1, 2009. The result of this funding method change was a decrease in the normal cost of the plan of $11.0 million and an increase in the Plan's actuarial accrued liability of $120.5 million.

Schedule of employer contributions for the past three years is shown below ($000 omitted):

| Plan Year | Annual Required Contribution | Percentage Contributed |
|---|---|---|
| 2011 | $ 22,877 | 100% |
| 2010 | 23,765 | 100% |
| 2009 | 16,614 | 100% |

Schedule of funding progress for the past three years is shown below ($000 omitted):

| Actuarial Valuation Date | Actuarial Value of Assets | Actuarial Accrued Liability (AAL) Entry Age | Unfunded Actuarial Accrued Liability (UAAL) | Funded Ratio | Covered Payroll | Unfunded Actuarial Accrued Liability as a Percent of Covered Payroll |
|---|---|---|---|---|---|---|
| | (a) | (b) | (b-a) | (a/b) | (c) | (b-a)/c |
| 4/1/2011 | $ 291,658 | $ 441,801 | $ 150,143 | 66.00% | $ 67,300 | 223.10% |
| 4/1/2010 | 254,919 | 419,353 | 164,435 | 60.80% | 66,879 | 245.87% |
| 4/1/2009 | 222,571 | 400,759 | 178,188 | 55.50% | 65,694 | 271.24% |

In 1994, NES established a non-qualified Supplemental Executive Retirement Plan (the "SERP"). The SERP was limited to certain employees of NES. Benefits accrued at the rate of 5 percent of

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**6. PENSION PLAN (continued)**

salary for each year of credited service not to exceed 12 years and vests at the rate of 20 percent for each year of service, reduced by the percentage accrued and vested under NES' qualified plan. Effective April 1, 2005, the Board merged the SERP with the NES Retirement Annuity and Survivors' Benefit Plan. Adding the SERP benefits to the Plan increased the funding requirements for the Plan, but the amounts that had accumulated in the SERP Trust were transferred to the Plan in order to offset those increased costs. Future payments that would have been made into the SERP Trust will be directed into the Plan.

At the time of conversion, no benefits had been paid from the SERP. Any change in funding requirements is reflected in the above schedule.

**7. DEFERRED COMPENSATION PLAN**

NES has a deferred compensation plan (the "457 Plan") created in accordance with Internal Revenue Code ("IRC") Section 457. The 457 Plan, which is available to all full-time employees, permits employees to defer a portion of their salary until future years. Employees may contribute up to the legal limit of their compensation to the 457 Plan with NES providing a matching contribution of up to 3 percent of compensation. The 457 Plan provides that assets or income of the 457 Plan shall be used for the exclusive purpose of providing benefits for participants and their beneficiaries or defraying reasonable expenses of administration of the 457 Plan. Since the assets of the 457 Plan are held in custodial and annuity accounts for the exclusive benefit of 457 Plan participants, the related assets of the 457 Plan are not reflected on the statements of net assets. Employees contributed $3.4 million and $3.3 million, and NES contributed $1.8 million to the 457 Plan during each of the years ended June 30, 2011 and 2010, respectively.

**8. POST-EMPLOYMENT BENEFITS**

In addition to the pension benefits described in Note 6 and the deferred compensation benefits described in Note 7, NES provides post-retirement medical, dental, and life insurance benefits to all employees who retire from NES under the provisions of the qualified plan and supplemental executive retirement plan. Medical and dental benefits are also provided to their spouses. As of June 30, 2011, approximately 549 retirees meet those eligibility requirements. Expenses for these post-retirement benefits have previously been recognized as retirees report claims. Those incurred claims totaled $9.0 million and $9.7 million for the years ended June 30, 2011 and 2010, respectively. During the year ended June 30, 2008, NES 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 NES' Other Post-Employment Benefits (OPEB) Plan. GASB Statement No. 45 requires the accrual of OPEB obligations over the working careers of plan members rather than as claims are incurred. The total expenses that were recognized were $18.1 million and $17.8 million for the years ended June 30, 2011 and 2010, respectively.

The NES OPEB Plan is a single-employer defined benefit plan funded through an irrevocable trust that was established during the year ended June 30, 2008. The Charter of the Metropolitan Government assigns the authority to establish and amend benefit provisions to NES. The OPEB Plan is not required to issue a separate financial report.

NES' 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.

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**8. POST-EMPLOYMENT BENEFITS (continued)**

The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over a 30-year period beginning April 1, 2009. The current rate is 25.68 percent of annual covered payroll. NES contributed 100 percent of the required contribution for the Plan year.

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events in the future. Amounts determined regarding the funded status of the plan and the annual required contributions of NES are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. The required schedule of funding progress presented below provides multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Projections of benefits are based on the substantive plan (the plan as understood by NES and plan members) and include the types of benefits in force at the valuation date and the pattern of sharing benefit costs between NES and the plan members to that point. Actuarial calculations reflect a long-term perspective and employ methods and assumptions that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets. Significant methods and assumptions were as follows:

Actuarial valuation date: April 1, 2011

Actuarial cost method: Entry age, normal method

Amortization method: Level percentage of pay, open

Remaining amortization period: 30 years, closed

Asset valuation method: Adjust expected assets on the valuation date toward market value of assets by an amount equal to one-third of the difference between expected and market asset values

The actuarial assumptions included (a) 8.0 percent investment rate of return and (b) projected salary increases of 4.5 percent. Both (a) and (b) included an inflation component. The assumptions include health care cost trend rate increases equal to 5 percent per year.

Schedule of employer contributions for the past three years is listed below:

| Plan Year | Annual Required Contribution | Percentage Contributed |
|---|---|---|
| 2011 | $ 18,123,818 | 100% |
| 2010 | 17,776,342 | 100% |
| 2009 | 15,382,816 | 100% |

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## 8. POST-EMPLOYMENT BENEFITS (continued)

Schedule of funding progress for the past three years is shown below ($000 omitted):

| Actuarial Valuation Date | Actuarial Value of Assets | Actuarial Accrued Liability (AAL) Entry Age | Unfunded Actuarial Accrued Liability (UAAL) | Funded Percentage | Covered Payroll | Unfunded Actuarial Accrued Liability as a Percent of Covered Payroll |
|---|---|---|---|---|---|---|
| | (a) | (b) | (b-a) | (a/b) | (c) | (b-a)/c |
| 4/1/2011 | $ 34,650 | $ 249,243 | $ 214,593 | 13.90% | $ 70,245 | 305.5% |
| 4/1/2010 | 22,532 | 248,269 | 225,737 | 9.10% | 69,216 | 326.1% |
| 4/1/2009 | 12,894 | 243,925 | 231,031 | 5.30% | 68,775 | 335.9% |

## 9. LEASES

Total rental expense entering into the determination of net operating income amounted to approximately $1.0 million and $1.2 million in 2011 and 2010, respectively. Rental expense consists primarily of payments for facilities rental and leasing arrangements for software licensing. NES leases these facilities and software under various cancelable lease agreements. Rental income is received under pole-attachment leases, which are accounted for as operating leases. These leases are cancelable. Therefore, future minimum rentals under these leases are not significant. Rental income from this source totaled $2.4 million and $2.5 million for the years ended June 30, 2011 and 2010, respectively.

## 10. RISK MANAGEMENT AND LIABILITY

NES is exposed to various risks of loss related to torts; theft or damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. NES is an agency of the Metropolitan Government and is covered under the Tennessee Governmental Tort Liability Act, TCA 29-20-101, et al, (the "Act") and is self-insured under the act for tort liability. NES is immune from any award or judgment for death, bodily injury and/or property damage in excess of the limits as set forth in the Act. Therefore, NES has not secured insurance coverage in excess of such limits. As of June 30, 2011, NES was a participant in the Metropolitan Government Insurance Pool (the "Pool") for coverage of most property losses. The Pool is operated as a common risk management and insurance program for several public entities, including NES, the Metropolitan Nashville Airport Authority, the Metropolitan Transit Authority and the Department of Water and Sewerage Services. The Pool is self-sustaining through member premiums. NES subrogates for all losses paid out for the negligence of other parties.

As of July 1, 2011, NES is no longer a participant of the Pool. With some of the sub-limits of the Pool coverage being reached as a result of the damage sustained by many participants of the Pool during the flood of 2010, NES deemed it prudent to withdraw from the Pool and obtain commercial property insurance that would no longer have shared sub-limits.

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## 10. RISK MANAGEMENT AND LIABILITY (continued)

NES is self-insured for employee dental and vision claims and self-insured up to $100,000 for employee medical claims. The changes in the insurance reserves for medical, dental and vision benefits for the years ended June 30, 2011 and 2010, are as follows ($000 omitted):

| | |
|---|---|
| Balance—June 30, 2009 | $ 2,082 |
| Payments | (18,863) |
| Incurred claims | 18,545 |
| Balance—June 30, 2010 | 1,764 |
| Payments | (19,777) |
| Incurred claims | 19,994 |
| Balance—June 30, 2011 | $ 1,981 |

NES continues to carry commercial insurance for all other risks of loss, including a retention with excess workers' compensation coverage and employee health and accident insurance. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

NES is party to various lawsuits filed against it in the normal course of business. Management does not believe that damages, if any, arising from outstanding litigation, will have a material effect on the financial position of NES.

## 11. RELATED PARTY TRANSACTIONS

NES had related party balances and transactions as a result of providing electric power to the Metropolitan Government and entities of the Metropolitan Government, as well as making tax-equivalent payments to the Metropolitan Government and other payments to entities of the Metropolitan Government. These balances and transactions as of and for the years ended June 30, 2011 and 2010, are summarized as follows ($000 omitted):

| | 2011 | 2010 |
|---|---|---|
| Balances: | | |
| Accounts receivable | $ 2,337 | $ 2,093 |
| Accounts payable | - | 8 |
| Transactions: | | |
| Commercial and industrial revenue—Metropolitan Government Entities | 57,416 | 50,465 |
| Street and highway lighting revenue—Metropolitan Government Entities | 6,266 | 5,519 |
| Tax equivalents operating expense—Metropolitan Government Entities | 25,917 | 25,006 |

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## 12. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair Value of Financial Instruments has been determined by NES using available market information. However, judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, the fair values are not necessarily indicative of the amounts that NES could realize in a current market exchange. The carrying amounts of cash and short-term investments, investments of special funds, accounts receivable, and accounts payable are a reasonable estimate of their fair value. The fair value of NES' long-term debt is estimated to be $514.1 million and $471.8 million at June 30, 2011 and 2010, respectively.

## 13. EXTRAORDINARY LOSS – FLOOD

NES experienced significant damage and loss in connection with heavy rainfall and flooding in the Metro Nashville /Davidson County area in early May 2010. The flooding resulted in the declaration of a Federal Disaster area by the Federal Emergency Management Agency. For the fiscal year ended June 30, 2011, we recorded an extraordinary loss of $2.4 million in damages to reflect the unusual and infrequent nature of the damage and related loss to NES' assets and the associated costs of restoration, repair and replacement. The $2.4 million extraordinary loss was made up of $1.9 million in expenditures and a reduction to the prior year receivable of $0.5 million. The extraordinary loss recognized in 2010 of $2.1 million consisted of $1.0 million in expenditures in excess of the estimated $5.3 million receivable from FEMA and a $1.1 million impairment loss on capital assets.

## 14. SUBSEQUENT EVENTS

NES' general philosophy is to fund half of planned capital improvements by borrowing from the bond market to allow NES to keep electric rates as low as possible. NES plans to issue new money bonds in the amount of approximately $125 million prior to the end of 2011 calendar year. NES also plans to re-issue certain existing debt at lower rates.

## 15. CORRECTION OF PRIOR YEAR ERROR

In connection with the preparation of the Board's fiscal 2011 financial statements, the Board's management determined that the balances of cash and cash equivalents and other investments in the Investment of Restricted Funds section of the Statement of Net Assets were improperly stated in the 2010 financial statements as certain of the securities included in cash and cash equivalents had an original maturity of greater than three months. Accordingly, those securities should have been presented as other investments in the Investment of Restricted Funds section of the Statement of Net Assets. The impact of this error was an overstatement in cash and cash equivalents of $13.6 million and a corresponding understatement of other investments.

In addition, the 2010 purchases and sales of securities presented as cash and cash equivalents in the Investment of Restricted Funds section of the Statement of Net Assets were improperly presented as purchases and sales of securities in the investing activity section on the statement of cash flows. These amounts should have been included in the total net increase in cash and cash equivalents which included only the unrestricted cash and cash equivalent balances and the net change therein.

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**15. CORRECTION OF PRIOR YEAR ERROR (continued)**

As of and for the year ended June 30, 2010, cash and cash equivalents and other investments within Investment of Restricted Funds on the Statement of Net Assets, the classifications within Note 3, and the impact on the Statement of Cash Flows have been restated from amounts previously reported to correct these errors ($000 omitted).

| | As Previously Reported | Adjustment | As Restated |
|---|---|---|---|
| **STATEMENT OF NET ASSETS JUNE 30, 2010** | | | |
| INVESTMENT OF RESTRICTED FUNDS: | | | |
| Cash and cash equivalents | $ 16,912 | $ (13,557) | $ 3,355 |
| Other investments | 74,425 | 13,557 | 87,982 |
| **STATEMENT OF CASH FLOWS YEAR ENDED JUNE 30, 2010** | | | |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Purchases of investment securities | (165,346) | 107,629 | (57,717) |
| Proceeds from sales and maturities of investment securities | 199,915 | (107,760) | 92,155 |
| Net cash provided by investing activities | 36,111 | (131) | 35,980 |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 14,285 | (131) | 14,154 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR | 91,812 | 3,486 | 95,298 |
| CASH AND CASH EQUIVALENTS AT END OF YEAR | $ 106,097 | $ 3,355 | $109,452 |

*2011 NES Annual Report photo credits:*
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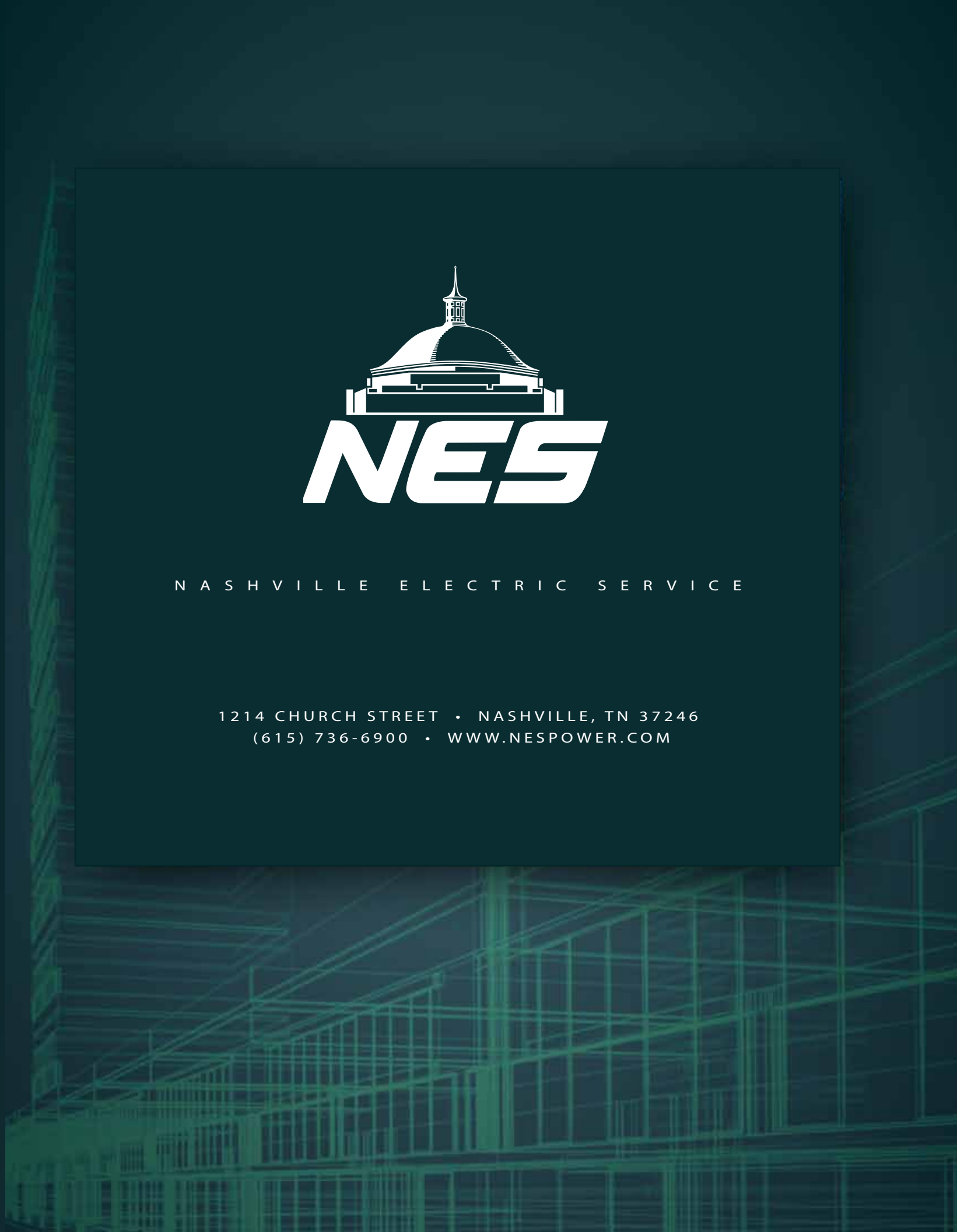

NES

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