

**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



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



**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)****Liquidity and Capital Resources**

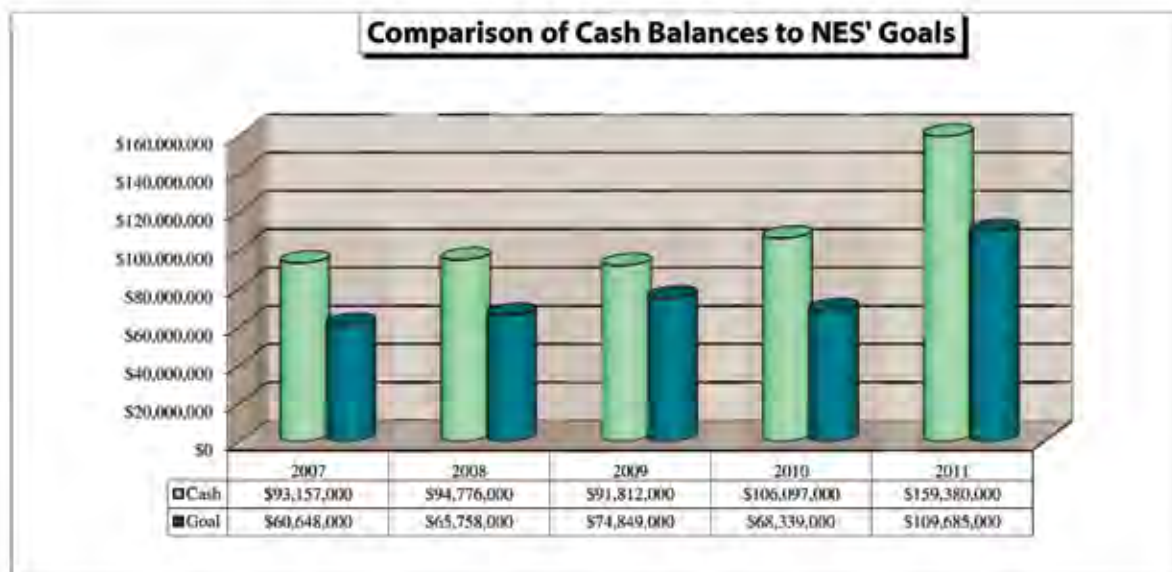
The Board has sufficient debt capacity and a strong financial position. Therefore, the tax-exempt bond market is expected to be a future source of liquidity to supplement the cash flow from operations. On June 27, 2008, the Board closed on the sale of the Metropolitan Government of Nashville and Davidson 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)**

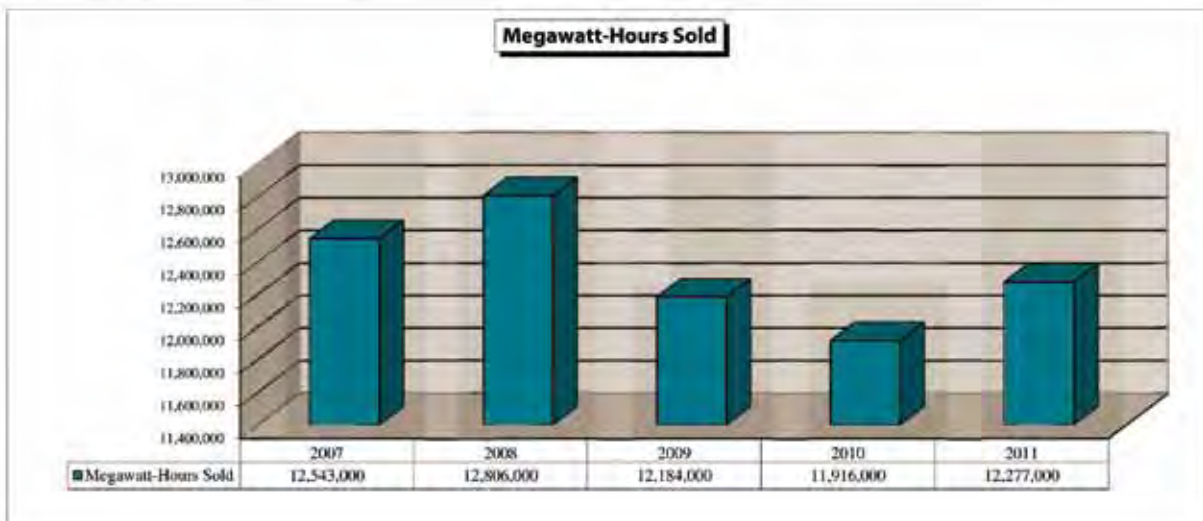
	Year Ended June 30,		Net Asset	Year Ended	Net Asset
	2011	2010	Effect	June 30, 2009	Effect
Operating Revenues	\$1,199,609	\$1,063,155	\$ 136,454	\$1,146,747	\$ (83,592)
Purchased Power	<u>927,065</u>	<u>816,152</u>	<u>(110,913)</u>	<u>915,005</u>	<u>98,853</u>
Margin	272,544	247,003	25,541	231,742	15,261
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	<u>2,415</u>	<u>2,110</u>	<u>(305)</u>	-	<u>(2,110)</u>
Increase in Net Assets	<u>\$ 28,887</u>	<u>\$ 13,705</u>	<u>\$ 15,182</u>	<u>\$ 16,005</u>	<u>\$ (2,300)</u>

**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)**

<b>Description</b>	<b>Fiscal 2011</b>	<b>Fiscal 2010</b>	<b>Increase (Decrease)</b>	<b>Fiscal 2009</b>	<b>Increase (Decrease)</b>
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	<u>10,880</u>	<u>3,879</u>	180.5%	<u>6,822</u>	(43.1%)
	<u>\$142,189</u>	<u>\$133,274</u>	6.7%	<u>\$128,229</u>	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 Uncollectible 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
<b>ASSETS</b>		
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	<u>2,190</u>	<u>2,094</u>
<b>TOTAL CURRENT ASSETS</b>	<u><b>329,741</b></u>	<u><b>265,956</b></u>
INVESTMENT OF RESTRICTED FUNDS:		
Cash and cash equivalents	51,524	3,355
Other investments	<u>3,737</u>	<u>87,982</u>
<b>TOTAL INVESTMENT OF RESTRICTED FUNDS</b>	<u><b>55,261</b></u>	<u><b>91,337</b></u>
UTILITY PLANT:		
Electric plant, at cost	1,366,207	1,322,130
Less: Accumulated depreciation	<u>(523,823)</u>	<u>(502,795)</u>
<b>TOTAL UTILITY PLANT, NET</b>	<u><b>842,384</b></u>	<u><b>819,335</b></u>
ENERGY CONSERVATION PROGRAMS' NOTES RECEIVABLE		
	884	227
UNAMORTIZED BOND ISSUANCE COSTS		
	2,258	2,496
OTHER NON-CURRENT ASSETS		
	<u>308</u>	<u>335</u>
<b>TOTAL ASSETS</b>	<u><b>1,230,836</b></u>	<u><b>1,179,686</b></u>

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

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**

	<b>2011</b>	<b>2010</b>
<b>OPERATING REVENUES:</b>		
Residential	\$ 507,787	\$ 446,321
Commercial and industrial	656,448	584,369
Street and highway lighting	16,066	14,583
Other	<u>19,308</u>	<u>17,882</u>
Total operating revenues	1,199,609	1,063,155
<b>PURCHASED POWER</b>	<u>927,065</u>	<u>816,152</u>
<b>MARGIN</b>	<u>272,544</u>	<u>247,003</u>
<b>OPERATING EXPENSES:</b>		
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	<u>47,523</u>	<u>46,034</u>
Total operating expenses	<u>217,304</u>	<u>206,154</u>
Operating income	<u>55,240</u>	<u>40,849</u>
<b>NON-OPERATING REVENUE (EXPENSE):</b>		
Interest income	513	1,328
Interest expense	<u>(24,451)</u>	<u>(26,362)</u>
Total non-operating expense	<u>(23,938)</u>	<u>(25,034)</u>
<b>EXTRAORDINARY LOSS – FLOOD</b>	<u>(2,415)</u>	<u>(2,110)</u>
<b>NET INCREASE IN NET ASSETS</b>	28,887	13,705
<b>NET ASSETS, beginning of year</b>	<u>501,809</u>	<u>488,104</u>
<b>NET ASSETS, end of year</b>	<u>\$ 530,696</u>	<u>\$ 501,809</u>

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**

	<b>2011</b>	<b>2010</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
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	<u>(26,969)</u>	<u>(26,267)</u>
Net cash provided by operating activities	<u>128,813</u>	<u>90,831</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:</b>		
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	<u>(29,266)</u>	<u>(29,117)</u>
Net cash used in capital and related financing activities	<u>(112,568)</u>	<u>(112,657)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchases of investment securities	(53,778)	(57,717)
Proceeds from sales and maturities of investment securities	138,023	92,155
Interest on investments	<u>962</u>	<u>1,542</u>
Net cash provided by investing activities	<u>85,207</u>	<u>35,980</u>
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>101,452</b>	<b>14,154</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	<b><u>109,452</u></b>	<b><u>95,298</u></b>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<b><u>\$ 210,904</u></b>	<b><u>\$ 109,452</u></b>

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	<u>(2,415)</u>	<u>(2,110)</u>
Net cash provided by operating activities	<u>\$ 128,813</u>	<u>\$ 90,831</u>

**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)	<u>69,326</u>	<u>-</u>	<u>(2,040)</u>	<u>67,286</u>
	<u>\$ 1,322,130</u>	<u>\$ 64,853</u>	<u>\$ (20,776)</u>	<u>\$ 1,366,207</u>
	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)	<u>54,211</u>	<u>15,115</u>	<u>-</u>	<u>69,326</u>
	<u>\$ 1,267,244</u>	<u>\$ 64,080</u>	<u>\$ (9,194)</u>	<u>\$ 1,322,130</u>

(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):

	<b>Balance June 30, 2010</b>	<b>Provision</b>	<b>Original Cost</b>	<b>Cost of Removal</b>	<b>Salvage</b>	<b>Balance June 30, 2011</b>
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	<u>26,720</u>	<u>1,997</u>	<u>(3,948)</u>	<u>-</u>	<u>(3)</u>	<u>24,766</u>
	<u>\$ 502,795</u>	<u>\$ 49,030</u>	<u>\$ (18,734)</u>	<u>\$ (10,641)</u>	<u>\$ 1,373</u>	<u>\$ 523,823</u>
	<b>Balance June 30, 2009</b>	<b>Provision</b>	<b>Original Cost</b>	<b>Cost of Removal</b>	<b>Salvage</b>	<b>Balance June 30, 2010</b>
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	<u>24,776</u>	<u>2,239</u>	<u>(307)</u>	<u>-</u>	<u>12</u>	<u>26,720</u>
	<u>\$ 468,839</u>	<u>\$ 47,728</u>	<u>\$ (7,826)</u>	<u>\$ (7,183)</u>	<u>\$ 1,237</u>	<u>\$ 502,795</u>

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	-
	<u>\$ 159,380</u>	<u>\$ 55,261</u>	<u>\$ -</u>	<u>\$ 214,641</u>	<u>-</u>

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
	<u>\$ 106,097</u>	<u>\$ 54,954</u>	<u>\$ 36,383</u>	<u>\$ 197,434</u>	<u>0.70</u>

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)
	<u>\$ 487,142</u>			<u>\$ 467,103</u>

**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)
	<u>\$ 506,027</u>			<u>\$ 487,142</u>

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**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):

	<u>Principal</u>	<u>Interest</u>
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	<u>14,074</u>	<u>1,027</u>
Total	<u>\$ 482,141</u>	<u>\$ 235,618</u>

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:

	<u>Amounts Outstanding</u>
1998 Series A Bonds	\$ 74,430,000

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**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):

<u>June 30, 2010</u>	<u>Repayments</u>	<u>Additions</u>	<u>June 30, 2011</u>
\$ 3,831	\$ (7,545)	\$ 16,425	\$ 12,711
<u>June 30, 2009</u>	<u>Repayments</u>	<u>Additions</u>	<u>June 30, 2010</u>
\$ 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

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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):

<u>Plan Year</u>	<u>Annual Required Contribution</u>	<u>Percentage Contributed</u>
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):

<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets</u>	<u>Actuarial Accrued Liability (AAL) Entry Age</u>	<u>Unfunded Actuarial Accrued Liability (UAAL)</u>	<u>Funded Ratio</u>	<u>Covered Payroll</u>	<u>Unfunded Actuarial Accrued Liability as a Percent of Covered Payroll</u>
	<u>(a)</u>	<u>(b)</u>	<u>(b-a)</u>	<u>(a/b)</u>	<u>(c)</u>	<u>(b-a)/c</u>
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:

<b>Plan Year</b>	<b>Annual Required Contribution</b>	<b>Percentage Contributed</b>
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	<u>18,545</u>
Balance—June 30, 2010	1,764
Payments	(19,777)
Incurred claims	<u>19,994</u>
Balance—June 30, 2011	<u>\$ 1,981</u>

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
<b>Balances:</b>		
Accounts receivable	\$ 2,337	\$ 2,093
Accounts payable	-	8
<b>Transactions:</b>		
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).

	<b>As Previously Reported</b>	<b>Adjustment</b>	<b>As Restated</b>
<b>STATEMENT OF NET ASSETS</b>			
<b>JUNE 30, 2010</b>			
INVESTMENT OF RESTRICTED FUNDS:			
Cash and cash equivalents	\$ 16,912	\$ (13,557)	\$ 3,355
Other investments	74,425	13,557	87,982
<b>STATEMENT OF CASH FLOWS</b>			
<b>YEAR ENDED JUNE 30, 2010</b>			
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	<u>91,812</u>	<u>3,486</u>	<u>95,298</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 106,097</u>	<u>\$ 3,355</u>	<u>\$109,452</u>

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