

Kerrville Public Utility Board

Basic Financial Statements
and Supplementary Information

September 30, 2011 and 2010

Kerrville Public Utility Board

Table of Contents

Financial Statements	Page
Independent Auditors' Report	1
Management's Discussion and Analysis	2
Basic Financial Statements	
Statements of Net Assets	12
Statements of Revenues, Expenses, and Changes in Fund Net Assets	14
Statements of Cash Flows	15
Notes to Financial Statements	16
Required Supplementary Information	
Schedule of Funding Progress	36

Independent Auditors' Report

The Board of Trustees
Kerrville Public Utility Board
Kerrville, Texas

We have audited the accompanying statements of net assets of Kerrville Public Utility Board, a component unit of the City of Kerrville, Texas, as of September 30, 2011 and 2010 and the related statements of revenues, expenses, and changes in fund net assets and cash flows for the years then ended. These financial statements are the responsibility of Kerrville Public Utility Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 Kerrville Public Utility Board's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide 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 Kerrville Public Utility Board as of September 30, 2011 and 2010, and the changes in its financial position and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 2 through 11, and the required supplementary information on page 36, are not a required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit this information and express no opinion on it.

Padgett, Stratemann & Co. LLP

Certified Public Accountants
December 5, 2011

SAN ANTONIO

100 N.E. LOOP 410, SUITE 1100
SAN ANTONIO, TEXAS 78216
210 828 6281

AUSTIN

811 BARTON SPRINGS ROAD, SUITE 550
AUSTIN, TEXAS 78704
512 476 0717

TOLL FREE: 800 879 4966
WEB: PADGETT-CPA.COM

Kerrville Public Utility Board

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2011 and 2010

As management of the Kerrville Public Utility Board ("KPUB"), we offer readers of KPUB's financial statements, this narrative overview and analysis of the financial activities of KPUB for the fiscal years ended September 30, 2011 and 2010. We encourage readers to consider the information presented herein in conjunction with additional information that we have furnished in the accompanying financial statements and notes. This discussion and analysis is designed to focus on current activities and resulting changes in financial position.

The audited financial statements presented this year include the following:

The Statements of Net Assets present information on KPUB's assets and liabilities. The difference between the total assets and total liabilities is reported as fund net assets. The fund net assets are classified as those invested in capital assets, net of related debt; those legally restricted; and those net assets unrestricted and available for operations. Based upon the liquidity of each, assets are categorized as either current or non-current. Non-current assets include cash, cash equivalents, investments, and interest receivable which have been legally restricted by contract, by bond resolutions or by action of KPUB's Board of Trustees. Other non-current assets include bond issuance costs and capital assets. Liabilities are categorized into current and non-current liabilities, highlighting the long-term nature of KPUB's net debt.

The Statements of Revenues, Expenses, and Changes in Fund Net Assets present the revenue and expenses for the fiscal year. Operating results including operating revenues and expenses are reported separately from non-operating activities. Operating expenses are presented by major cost categories. Operating income is available for payment of KPUB's debt service, system improvements, payments to the City of Kerrville, and to assist in meeting unforeseen contingencies.

The Statements of Cash Flows present cash activity prepared using the direct method which reports cash receipts and payments, and includes a reconciliation of operating income to net cash provided by operating activities. The cash activity is categorized into cash flows from operating activities, capital and related financial activities, non-capital financing activities and investing activities.

KPUB's excess of assets over liabilities is reported as fund net assets. At the end of the 2011 fiscal year, this amounted to \$39,223,374, as compared to \$38,162,739 as of September 30, 2010.

Major Transactions and Events:

Pursuant to the purchase of the Kerrville District Electric Distribution System (the "System") in December 1987 from the Lower Colorado River Authority ("LCRA"), KPUB entered into an agreement with LCRA for the purchase of power. In early 1988, the wholesale power agreement was amended. The amended wholesale power agreement provides that LCRA will supply electric power and energy to KPUB for its use and for resale to customers of the System. The minimum term of the amended agreement is through June 2016 and is renewable for successive periods of ten years thereafter, unless notice of intent to terminate is given by either party prior to the end of the eighth year of the original or

Kerrville Public Utility Board

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2011 and 2010

(Continued)

any successive term. Under the terms of the amended agreement, KPUB agrees not to enter into a contract for power and energy with any other entity without prior approval of LCRA. KPUB may, however, purchase from others any portion of its electric and power requirements which cannot be supplied by LCRA. The LCRA, through its Price Select Program, offers all LCRA customers the option of buying 10% of their energy from alternate power providers. A second option is also provided which allows customers to buy other customers' 10% options and use the additional contracts to increase the amount of energy that could be bought from alternate power suppliers.

In fiscal year 2004, KPUB and New Braunfels Utilities ("NBU") filed a lawsuit for a declaratory judgment against the LCRA. Cause No. 04-87-B was filed in the 198th Judicial District Court in Kerr County, Texas, with KPUB and NBU requesting an interpretation of the 1987 amendment of the Wholesale Power Agreement.

KPUB and NBU claimed in the lawsuit that they were charged costs and incurred other expenses after electing not to participate in the acquisition, by LCRA from Calpine Corporation, of the remaining fifty percent interest in Lost Pines Power Project located in Bastrop, Texas. KPUB and NBU also contested the calculation of their maximum respective contract loads, resulting from the decision not to participate in the acquisition of the fifty percent interest in Lost Pines Power Project.

KPUB and NBU reached a tentative settlement agreement in mediation on December 9, 2005. Pursuant to the Agreement, the parties agreed as follows:

1. LCRA agreed that at such time that energy which originates from power generated by Lost Pines Project 2 to NBU or KPUB, such energy shall be charged at a Heat Rate of 8200 Btus per kilowatt hour multiplied by the LCRA weighted average cost of gas.
2. LCRA would pay KPUB \$245,499 for overpayment of energy for 2005.
3. The contract load for KPUB would be established as 80 megawatts ("MW") for KPUB.
4. LCRA agreed to pay KPUB a one-time payment of \$100,000 for contract load considerations for the years 2004 and 2005.
5. LCRA agreed to credit KPUB in the amount of \$169,146 which was credited to other members of KPUB's energy purchasing group for energy above 105.5 MW for KPUB for 2005.
6. LCRA also agreed to deduct any expenses for equity, operation and maintenance expenses, and fuel costs attributed to KPUB from Lost Pines Project 2.

During fiscal year 2007, management entered into two aggregation groups for the purchases outside LCRA. One aggregation group of nine which includes Boerne, NBU, San Bernard Electric Cooperative, the Cities of Georgetown and Seguin, Guadalupe Valley Electric Cooperative, Bandera Electric

Kerrville Public Utility Board

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2011 and 2010

(Continued)

Cooperative, Central Texas Electric Cooperative, and KPUB went out for bid in 2007 for their 10% energy. This bid resulted in the aggregation group entering into a three year contract with City Public Service of San Antonio ("CPS Energy"). KPUB received 28.2 MW of energy under this contract until June 24, 2010 when LCRA began phasing out the optional purchase program and then 8.9 MW of energy until June 24, 2011, when the program was completely phased out.

The second aggregation group includes Central Texas Electric Cooperative and the City of Georgetown. For fiscal year 2010, this energy resulted in 8.9 MW through June 24, 2010, when the term ended. This energy was bid and awarded to CPS Energy for fiscal year 2010.

As with previous years KPUB went out for bids and selected CPS Energy for the energy above the 80 MW cap for fiscal years 2011 and 2010.

At a Special Called Meeting on October 13, 2010, the Kerrville Public Utility Board of Trustees unanimously passed Resolution 10-20 providing notice to the Lower Colorado River Authority to terminate the Wholesale Power Agreement effective June 25, 2016. Prior to this decision, management solicited wholesale power proposals by issuing a Request for Proposal on June 16, 2010. A total of 43 proposals were received from 17 different suppliers. From these proposals, on September 21, 2011, KPUB selected CPS Energy of San Antonio to be its major power supplier effective June 25, 2016. The agreement is for an initial term of seven and one-half years with an option for a three year extension. Under the terms of the agreement, CPS Energy will supply 15 MW of KPUB's 35 MW of base load and all of KPUB's load following requirements. CPS energy will supply 10% of KPUB's energy from renewable power sources beginning in calendar year 2017 and that level will increase each year to a maximum of 15% in calendar year 2023.

Under a separate agreement CPS Energy will supply KPUB's Qualified Scheduling Entity services in the ERCOT market.

KPUB will still receive power from LCRA through its GenTex agreement that provides KPUB with 4.1% of the capacity and energy from the Lost Pines Power Project Unit 1. This will account for approximately 10 MW of KPUB's base load and the agreement continues through the operational life of the plant. KPUB will continue to monitor pricing offers in the ERCOT market and will issue a subsequent Request for Proposal for the 10 MW remainder of its base load at a future date.

Comparison of Fiscal Years 2011 and 2010

Operating revenue of \$47.0 million represents an increase of approximately \$6.1 million or 14.9% above the period ended September 30, 2010. This increase in operating revenue resulted from an increase in the average cost of purchased power recoveries resulting from the increase in higher purchased power costs from \$0.057 per kWh to \$0.069 per kWh. Although kWh sales for the year totaled 494,571,058,

Kerrville Public Utility Board

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2011 and 2010

(Continued)

down 0.26% from a total of 495,882,332 in 2010, the operating revenue increase primarily resulted from the 21.1% increase in KPUB's cost of power per kWh. The average number of customers in 2011 increased by 120 to 21,551, an increase of 0.6% from the prior year's level of 21,431.

Operating expense increased by \$6.7 million or 17.6% in fiscal year 2011 from the 2010 level. The increase in cost of purchased power, an increase of \$6.4 million, accounted for the majority of the operating expense increase. Other operating expenses, excluding depreciation and amortization, increased by 7.8%, or by \$455,447. An increase in distribution maintenance expense of \$165,798 reflected an increase in the maintenance of line transformers expense of \$57,595, or 529.5%; an increase in the maintenance of station equipment expense of \$49,457, or 41.7%; an increase in the maintenance of meter expense of \$30,749, or 142.5%; a decrease in the maintenance of underground line expense of \$17,097, or 17.5%; and an increase in maintenance supervision and engineering expense of \$43,436, or 114.3%. Total distribution operation expense decreased by \$64,359, or 8.7%; below the 2010 level. A decrease in meter operation expense of \$20,348, or 13.8%; a decrease in miscellaneous distribution operation expense of \$14,183, or 3.3%; a decrease in operation supervision and engineering expense of \$11,039, or 14.2%; a decrease in station operation expense of \$9,654, or 42.5%; and a decrease in the underground line operation expense of \$4,906, or 100%, accounted for the decrease from 2010. Administrative and other expenses increased by \$354,008, or 10.0%. Customer accounts expense increased by \$113,132, or 15.5%. This increase resulted from an increase in customer records and collection expense of \$56,151, or 12.7%; an increase in supervision expense by \$23,126, or 31.7%; an increase in uncollectible accounts expense of \$22,673, or 36.7%; and an increase in meter reading expense of \$10,969, or 7.2%. Administrative and general expense increased by \$230,205, or 9.0%. This increase resulted from an increase in outside services employed expense of \$189,714, or 55.2%; an increase in employees pensions and benefits of \$42,562, or 3.7%; an increase in administrative and general salaries expense of \$12,560, or 1.9%; and a decrease in office supplies and expense of \$17,308, or 5.1%. Depreciation and amortization expense decreased by \$166,424, or 8.3%. As a result of the combination of the above, operating income decreased by \$572,679, or 18.5%, below the year ended September 30, 2010.

Net non-operating expenses of \$1,559,086 reflected an increase of \$23,298 from the amount expensed in the prior year 2010. As a result of the continued decrease in interest rates available on invested funds, a decrease of \$27,139 in interest earned and unrealized gain/(loss) on investments was realized as compared to fiscal year 2010.

Interest and debt amortization decreased by \$111,660 from the fiscal year 2010. As a result of higher gross revenue, the transfer to the City of Kerrville, calculated at 3% of gross revenue, increased by \$201,713, or 16.2% over fiscal year 2010. Other non-operating revenue increased by \$93,894, or 56.2%, over the amount realized in fiscal year 2010.

Capital contributions, which totaled \$68,015 in fiscal year 2010 increased to \$105,047 in fiscal year 2011. This increase of \$37,032 represented an increase of 54.4% over fiscal year 2010.

Kerrville Public Utility Board

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2011 and 2010

(Continued)

The change in net assets for the fiscal year 2011 was \$1,060,635 as compared to \$1,619,580 for the prior period. Total net assets at September 30, 2011 totaled \$39,223,374 as compared to \$38,162,739.

Total assets at September 30, 2011 were \$53.8 million, as compared to \$52.1 million at September 30, 2010. Total current assets increased by \$619,700. Cash and cash equivalents increased by \$395,462 from fiscal year 2010. Investments, net of customer deposits, decreased by \$3,549,634 from a level of \$8,394,507 in 2010 to \$4,844,873 at September 30, 2011. Customer accounts receivable, net of allowances, increased by a total of \$3,696,387 at September 30, 2011, as compared to September 30, 2010. Materials and supplies inventory increased by \$54,839 when compared to the previous year. Total non-current assets increased by \$1,069,245, or 2.8%, at the end of fiscal year 2011. Investments subject to governing board designation remained at the same level at September 30, 2011 of \$3.5 million when compared to September 30, 2010. Net capital assets increased by \$1,110,894 due to continued improvement and expansion of the system of \$3,020,047, net of regular depreciation and retirement of the systems assets. The fund net assets-invested in capital assets net of related debt increased by \$3,289,410 due to additions to capital assets in 2011, principal payments made on long-term debt and depreciation of capital assets.

Total liabilities at September 30, 2011 were \$14.6 million, as compared to \$14.0 million at September 30, 2010. Current liabilities increased by \$2,918,019. The purchased power payable increased by \$2,437,727. Accounts payable and accrued liabilities decreased by \$122,578, totaling \$1,054,524 at September 30, 2011 as compared to \$1,177,102 at September 30, 2010. The current portion of revenue bonds payable increased from \$2,195,000 at September 30, 2010 to \$2,295,000 at September 30, 2011. The over-collected power cost adjustment balance of \$26,632 at September 30, 2010 increased to an over-collected power cost adjustment of \$529,502 at September 30, 2011. Non-current liabilities at September 30, 2011 decreased by \$2.3 million from the total non-current liabilities at September 30, 2010. This decrease resulted from the transfer of \$2.3 million in the long-term revenue bond debt from the non-current liability at November 2010.

Comparison of Fiscal Years 2010 and 2009

Operating revenue of \$40.9 million represents a decrease of approximately \$0.7 million or 1.7% below the period ended September 30, 2009. This decrease in operating revenue resulted in part from a decrease in average cost of purchased power recoveries resulting from the decrease in lower purchased power costs from \$0.061 per KWH to \$0.057 per KWH. Although KWH sales for the year totaled 495,882,332, up 5.2% from a total of 471,572,994 in 2009, the operating revenue decrease primarily resulted from the 7.0% decrease in KPUB's cost of power per KWH. The average number of customers in 2010 increased by 164 to 21,431, an increase of 0.8% from the prior year's level of 21,267.

Operating expense decreased by \$0.5 million or 1.3% in fiscal year 2010 from the 2009 level. The decrease in cost of purchased power, a decrease of \$1.2 million, accounted for the operating expense decrease. Other operating expenses, excluding depreciation and amortization, increased by 12.6%, or by \$648,669. An increase in distribution expense of \$315,156 reflected an increase in the maintenance

Kerrville Public Utility Board

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2011 and 2010

(Continued)

of overhead lines expense of \$158,596, or 14.9%; a decrease in station equipment expense of \$34,154, or 22.4%; an increase in the maintenance of underground lines expense of \$32,158, or 49.0%; and an increase in the maintenance of meters expense of \$3,747, or 21.0%. Total distribution operation expense increased by \$135,160, or 22.5%, over the 2009 level. An increase in operation supervision and engineering expense of \$37,393, or 92.7%; an increase in street lighting and signal systems operating expense of \$31,135, or 191.4%; an increase in meter operating expense of \$29,893, or 25.4%; and an increase in miscellaneous distribution operating expense of \$26,830, or 6.7%, accounted for the increase over 2009. Administrative and other expenses increased by \$333,513, or 10.4%. Customer accounts expense decreased by \$111,753, or 13.3%. This decrease resulted from a decrease in supervision expense of \$6,507, or 8.2%; a decrease in meter reading expense of \$25,315, or 14.3%; a decrease in customer records and collections expense of \$76,538, or 14.7%; and a decrease in uncollectible accounts expense of \$3,393, or 5.2%. Customer service and informational expense increased by \$69,893, or 80.3%. This increase resulted from an increase in supervision expense of \$6,797, or 129.4%; an increase in customer assistance expense of \$53,355, or 99.3%; and an increase in advertising expense of \$10,078, or 36.5%. Administrative and general expense increased by \$379,259, or 17.0%. This increase resulted from an increase in administrative and general salaries of \$163,000, or 32.1%; an increase in office supplies and expenses of \$23,242, or 7.3%; an increase in property insurance expense of \$4,097, or 21.7%; an increase in injuries and damages expense of \$9,747, or 46.8%; and an increase in employee pension and benefits expense of \$166,372, or 17.2%. Depreciation and amortization expense increased by \$25,938, or by 1.3%. As a result of the combination of the above, operating income decreased by \$221,124, or 6.7%, below the year ended September 30, 2009.

Net non-operating expenses of \$1,535,788 reflected a decrease of \$215,320 from the amount expensed in the prior year 2009. As a result of the decrease in interest rates available on invested funds, a decrease of \$168,129 in interest earned and unrealized gain/(loss) on investments was realized as compared to fiscal year 2009. Interest and debt amortization decreased by \$102,308 from the fiscal year 2009. As a result of lower gross revenue, the transfer to the City of Kerrville, calculated at 3% of gross revenue, decreased by \$115,405, or 8.5% below fiscal year 2009. Other non-operating income increased by \$165,736 from \$1,418 in fiscal year 2009 to \$167,154 in fiscal year 2010.

Capital contributions, which totaled \$140,271 in fiscal year 2009 decreased to \$68,015 in fiscal year 2010. This decrease of \$72,256 represented a decrease of 51.5% from fiscal year 2009.

The change in net assets for the fiscal year 2010 was \$1,619,580 as compared to \$1,697,640 for the prior period. Total net assets at September 30, 2010 totaled \$38,162,739 as compared to \$36,543,159.

Total assets at September 30, 2010 were \$52.1 million, as compared to \$51.9 million at September 30, 2009. Total current assets increased by \$142,999. Cash and cash equivalents decreased by \$75,573 from fiscal year 2009. Investments, net of customer deposits, decreased by \$469,748 from a level of \$8,864,255 in 2009 to \$8,394,507 at September 30, 2010. Customer accounts receivable, net allowances, increased by a total of \$676,690 at September 30, 2010, as compared to September 30, 2009. Materials and supplies inventory increased by \$25,156 when compared to the previous year.

Kerrville Public Utility Board

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2011 and 2010

(Continued)

Total non-current assets increased by \$60,442, or 0.2%, at the end of fiscal year 2010. Investments subject to governing board designation remained at the same level at September 30, 2010, of \$3.5 million when compared to September 30, 2009. Net capital assets increased by \$84,949 due to continued improvement and expansion of the system of \$2,251,781, net of regular depreciation and retirement of the systems assets. The fund net assets-invested is capital assets net of related debt increased by \$2,153,462 due to additions to capital assets in 2010, principal payments made on long-term debt and depreciation of capital assets.

Total liabilities at September 30, 2010 were \$14.0 million, as compared to \$15.4 million at September 30, 2009. Current liabilities increased by \$771,737. The purchased power payable increased by \$665,106. Accounts payable and accrued liabilities increased by \$202,947, totaling \$1,177,102 at September 30, 2010 as compared to \$974,155 at September 30, 2009. The current portion of revenue bonds payable increased from \$2,085,000 at September 30, 2009 to \$2,195,000 at September 30, 2010. The over-collected power cost adjustment balance of \$232,948 at September 30, 2009 decreased to \$26,632 at September 30, 2010. Non-current liabilities at September 30, 2010 decreased by \$2.2 million from the total non-current liabilities at September 30, 2009. This decrease resulted from the transfer of \$2.2 million in the long-term revenue bond debt from the non-current liability at November 2009.

Summary Schedule of Net Assets

	September 30,		
	2011	2010	2009
Assets:			
Current and other assets	\$ 24,021,713	\$ 23,443,662	\$ 23,325,170
Capital assets, net	29,816,735	28,705,841	28,620,892
Total assets	53,838,448	52,149,503	51,946,062
Liabilities:			
Current liabilities	9,539,897	6,621,878	5,850,141
Long-term liabilities	5,075,177	7,364,886	9,552,762
Total liabilities	14,615,074	13,986,764	15,402,903
Fund net assets:			
Invested in capital assets, net of related debt	23,076,080	19,786,670	17,633,208
Restricted	4,623,869	4,578,027	4,519,223
Unrestricted	11,523,425	13,798,042	14,390,728
Total fund net assets	\$ 39,223,374	\$ 38,162,739	\$ 36,543,159

Kerrville Public Utility Board

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2011 and 2010

(Continued)

Summarized Schedule of Revenues, Expenses, and Changes in Fund Net Assets

	Years Ended September 30,		
	2011	2010	2009
Operating revenues:			
Sales of electricity	\$ 46,436,758	\$ 40,373,373	\$ 41,043,390
Other	523,919	492,688	538,444
Total operating revenues	46,960,677	40,866,061	41,581,834
Operating expenses:			
Purchased power	36,339,376	29,961,104	31,130,360
Distribution	2,383,448	2,282,009	1,966,853
Administrative and other	3,882,653	3,528,645	3,195,132
Depreciation and amortization	1,840,526	2,006,950	1,981,012
Total operating expenses	44,446,003	37,778,708	38,273,357
Operating income	2,514,674	3,087,353	3,308,477
Non-operating revenues (expenses):			
Interest on investments	28,364	55,503	223,632
Interest and debt amortization expense	(404,887)	(516,547)	(618,855)
Payments to City of Kerrville	(1,443,611)	(1,241,898)	(1,357,303)
Other non-operating revenue	261,048	167,154	1,418
Net non-operating expenses	(1,559,086)	(1,535,788)	(1,751,108)
Income before contributions	955,588	1,551,565	1,557,369
Capital contributions	105,047	68,015	140,271
Change in fund net assets	1,060,635	1,619,580	1,697,640
Fund net assets at beginning of year	38,162,739	36,543,159	34,845,519
Fund net assets at end of year	\$ 39,223,374	\$ 38,162,739	\$ 36,543,159

Kerrville Public Utility Board

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2011 and 2010

(Continued)

Capital Assets and Long-Term Debt Activity

KPUB's debt service requirements for fiscal year 2011 increased by \$325 from the fiscal year 2010 total of \$2,603,741 to the fiscal year 2011 total of \$2,604,066. KPUB's 2001 Refunding Bonds were sold with a debt rating of "AAA" by Fitch and Standard & Poor's and are insured by Financial Security Assurance Inc. Debt service coverage calculated, per the bond ordinances, was 1.73x and 1.97x for fiscal years 2011 and 2010, respectively. Each year exceeds the minimum required coverage of 1.10x. For more detailed information on long-term debt, refer to note 4 of notes to financial statements.

KPUB's debt service requirements for the fiscal year 2010 totaled \$2,603,741, as compared to a fiscal year 2009 total of \$2,619,775. Debt service coverage calculated, per the bond ordinance, was 1.97x and 2.07x for the fiscal years 2010 and 2009, respectively. Each year exceeded the minimum required coverage of 1.10x.

For the fiscal years ended September 30, 2011 and 2010, total expenditures for new construction and net removal costs totaled \$3,020,047 and \$2,251,781, respectively. Major capital expenditures and construction projects included: (1) extensions of and improvements to overhead and underground facilities to increase capacity and provide service to new customers and developments; (2) improvements to and replacements on the overhead and underground distribution system for enhanced capacity and reliability; (3) major improvements to KPUB's substations for enhanced capacity and reliability; (4) improvements to KPUB's information technology infrastructure; and (5) building improvements.

For the fiscal years ended September 30, 2010 and 2009, total expenditures for new construction and net removal costs totaled \$2,251,781 and \$1,953,979, respectively. Major capital expenditures and construction projects included: (1) extensions of and improvements to overhead and underground facilities to increase capacity and provide service to new customers and developments; (2) improvements to and replacements on the overhead and underground distribution system for enhanced capacity and reliability; (3) improvements to KPUB's substations for enhanced capacity and reliability; (4) improvements to KPUB's information technology infrastructure; (5) building improvements; and (6) fleet additions and replacements.

Actual expenses for capital construction and removal costs were funded entirely from earnings. For more detailed information about capital assets, refer to note 3 of notes to financial statements.

Kerrville Public Utility Board

Management's Discussion and Analysis

Fiscal Years Ended September 30, 2011 and 2010

(Continued)

Summary of Capital Assets – Net of Depreciation

	<u>September 30,</u>		
	<u>2011</u>	<u>2010</u>	<u>2009</u>
Distribution system	\$ 23,534,706	\$ 23,805,964	\$ 24,233,573
Land, buildings, and equipment	2,365,510	1,752,076	1,793,997
Transportation equipment	1,005,508	1,127,389	1,078,739
Other	463,726	443,176	458,667
Construction in progress	<u>2,447,285</u>	<u>1,577,236</u>	<u>1,055,916</u>
Capital assets, net of depreciation	<u>\$ 29,816,735</u>	<u>\$ 28,705,841</u>	<u>\$ 28,620,892</u>

Request for Additional Information

This financial report is designed to provide a general overview for the Kerrville Public Utility Board's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Chief Financial Officer, P.O. Box 294999, Kerrville Public Utility Board, Kerrville, Texas 78029-4999.

Basic Financial Statements

Kerrville Public Utility Board

Statements of Net Assets

September 30, 2011 and 2010

Assets	<u>2011</u>	<u>2010</u>
Current assets:		
Cash and cash equivalents (note 2)	\$ 538,961	\$ 143,499
Investments (note 2)	4,844,873	8,394,507
Customer accounts receivable, net of allowance for doubtful accounts of \$91,241 and \$98,009 and including unbilled revenues of \$4,529,890 and \$2,820,163 in 2011 and 2010, respectively	8,639,162	4,942,775
Materials and supplies inventory	951,168	896,329
Other	72,887	50,241
Total current assets	<u>15,047,051</u>	<u>14,427,351</u>
Non-current assets:		
Restricted:		
Cash and cash equivalents (note 2):		
Reserve fund	2,760	2,733
Interest and sinking fund	17,604	17,428
Total cash and cash equivalents	<u>20,364</u>	<u>20,161</u>
Investments (note 2):		
Customer deposits	629,522	640,717
Reserve fund	2,515,914	2,560,417
Interest and sinking fund	2,234,600	2,191,329
Total investments	<u>5,380,036</u>	<u>5,392,463</u>
Investments subject to Governing Board designation (note 2):		
Equipment replacement fund	1,750,000	1,750,000
Emergency repair and contingency fund	1,763,053	1,763,053
	<u>3,513,053</u>	<u>3,513,053</u>
Other non-current assets, net of accumulated amortization of \$296,710 and \$267,283 in 2011 and 2010, respectively	61,209	90,634
Capital assets (note 3):		
Electric plant in service	54,082,112	53,063,193
Less accumulated depreciation	(26,712,662)	(25,934,588)
	<u>27,369,450</u>	<u>27,128,605</u>
Construction work in progress	2,447,285	1,577,236
Net capital assets	<u>29,816,735</u>	<u>28,705,841</u>
Total non-current assets	<u>38,791,397</u>	<u>37,722,152</u>
Total assets	<u>\$ 53,838,448</u>	<u>\$ 52,149,503</u>

Notes to financial statements form an integral part of these statements.

Kerrville Public Utility Board

Statements of Net Assets

September 30, 2011 and 2010

(Continued)

Liabilities	2011	2010
Current liabilities:		
Accounts payable – purchased power (note 6)	\$ 5,660,871	\$ 3,223,144
Accounts payable and accrued liabilities (notes 5 and 9)	1,054,524	1,177,102
Current portion of revenue bonds (note 4)	2,295,000	2,195,000
Other liabilities	529,502	26,632
Total current liabilities	<u>9,539,897</u>	<u>6,621,878</u>
Non-current liabilities:		
Long-term revenue bonds, net (note 4)	4,445,655	6,724,170
Customer deposits	629,522	640,716
Total non-current liabilities	<u>5,075,177</u>	<u>7,364,886</u>
Total liabilities	<u>14,615,074</u>	<u>13,986,764</u>
Fund net assets:		
Invested in capital assets, net of related debt	23,076,080	19,786,670
Restricted:		
Debt service	2,105,195	2,014,877
Bond resolution	2,518,674	2,563,150
Unrestricted	11,523,425	13,798,042
Total fund net assets	<u>\$ 39,223,374</u>	<u>\$ 38,162,739</u>

Notes to financial statements form an integral part of these statements.

Kerrville Public Utility Board

Statements of Revenues, Expenses, and Changes in Fund Net Assets

Years Ended September 30, 2011 and 2010

	2011	2010
Operating revenues (notes 4 and 5):		
Sales of electricity	\$ 46,436,758	\$ 40,373,373
Other	523,919	492,688
Total operating revenues	46,960,677	40,866,061
Operating expenses:		
Purchased power (note 6)	36,339,376	29,961,104
Distribution	2,383,448	2,282,009
Administrative and other	3,882,653	3,528,645
Depreciation and amortization	1,840,526	2,006,950
Total operating expenses	44,446,003	37,778,708
Operating income	2,514,674	3,087,353
Non-operating revenues (expenses):		
Interest and unrealized gain/(loss) on investments	28,364	55,503
Interest and debt amortization expense	(404,887)	(516,547)
Payments to City of Kerrville (note 5)	(1,443,611)	(1,241,898)
Other	261,048	167,154
Net non-operating expenses	(1,559,086)	(1,535,788)
Income before contributions	955,588	1,551,565
Capital contributions	105,047	68,015
Change in fund net assets	1,060,635	1,619,580
Fund net assets at beginning of year	38,162,739	36,543,159
Fund net assets at end of year	\$ 39,223,374	\$ 38,162,739

Notes to financial statements form an integral part of these statements.

Kerrville Public Utility Board

Statements of Cash Flows

Years Ended September 30, 2011 and 2010

	2011	2010
Cash flows from operating activities:		
Cash received from customers	\$ 43,264,290	\$ 40,189,371
Cash payments to suppliers for goods and services	(36,100,819)	(31,694,017)
Cash payments to employees for services	(3,416,218)	(3,080,534)
Net cash provided by operating activities	3,747,253	5,414,820
Cash flows from non-capital financing activities:		
Payments to City of Kerrville	(1,443,611)	(1,241,898)
Net cash used in non-capital financing activities	(1,443,611)	(1,241,898)
Cash flows from capital and related financing activities:		
Cash paid for additions to capital assets	(3,003,562)	(2,235,295)
Interest paid	(404,887)	(516,547)
Principal payments on revenue bonds	(2,195,000)	(2,085,000)
Contributions in aid of construction	105,047	68,015
Net cash used in capital and related financing activities	(5,498,402)	(4,768,827)
Cash flows from investing activities:		
Proceeds from sales and maturities of investments	43,556,268	38,299,155
Purchases of investments	(40,003,915)	(37,844,600)
Interest income	38,072	65,978
Net cash provided by investing activities	3,590,425	520,533
Net increase (decrease) in cash and cash equivalents	395,665	(75,372)
Cash and cash equivalents at beginning of year	163,660	239,032
Cash and cash equivalents at end of year	559,325	163,660
Cash and cash equivalents:		
Restricted	20,364	20,161
Unrestricted	538,961	143,499
Cash and cash equivalents at end of year	\$ 559,325	\$ 163,660
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 2,514,674	\$ 3,087,353
Depreciation and amortization	1,840,526	2,006,950
Provision for uncollectible accounts	(6,768)	1,294
Transportation clearing and other amortization	68,627	159,882
Other	261,048	167,154
Changes in assets and liabilities:		
Increase in customer accounts receivable, net	(3,689,619)	(677,984)
Increase in materials and supplies inventory	(54,839)	(25,156)
(Increase) decrease in other current assets	(22,646)	13,526
Increase in accounts payable and accrued liabilities	2,818,019	661,737
Decrease in other non-current assets	29,425	29,426
Decrease in customer deposits payable	(11,194)	(9,362)
Net cash provided by operating activities	\$ 3,747,253	\$ 5,414,820
 NON-CASH TRANSACTIONS:		
Unrealized gains/(losses) relating to changes in fair value of investments	\$ (3,175)	\$ (17,090)

Notes to financial statements form an integral part of these statements.

Notes to Financial Statements

Kerrville Public Utility Board

Notes to Financial Statements

September 30, 2011 and 2010

1. Summary of Significant Accounting Policies

Reporting Entity

On February 10, 1987, the City Council of Kerrville, Texas approved Resolution No. 87-106, naming a five-member board of trustees, pursuant to Article 1115 Revised Civil Statutes of Texas, and calling for an election for approval of issuance of bonds for the purpose of acquiring the Kerrville District Electric Distribution System (the "System") from the Lower Colorado River Authority ("LCRA"). Voter approval was obtained on March 17, 1987, and the City Council approved Bond Ordinance 87-45 on November 24, 1987 officially establishing and empowering the Kerrville Public Utility Board ("KPUB") for the purpose of controlling, managing, and operating the System, as well as authorizing the issuance of \$29.5 million of City of Kerrville, Texas Electric System Revenue Bonds for acquisition, extension, and improvement of the System. KPUB is legally separate from the City of Kerrville (the "City"). A purchase agreement, a wholesale power agreement, and an operating agreement between KPUB and LCRA were signed and KPUB officially started operating the System on December 11, 1987 with LCRA as the operating agent.

The City reports KPUB as a proprietary component unit in its Comprehensive Annual Financial Report ("CAFR"). KPUB operates under one industry segment with all operations in the Kerrville, Texas area. KPUB, as part of the City, is not subject to federal income taxes.

Utility Rate Regulation

KPUB is not subject to regulation by the Public Utility Commission of Texas (the "PUC") with regard to its operation or rates charged for electric service to customers within the boundaries of the System. The City has exclusive original jurisdiction over the rates charged to ratepayers who reside outside the City's boundaries. Texas courts have held that the PUC has appellate jurisdiction to determine retail municipal electric rates outside the City limits if a qualified petition is filed.

Basis of Accounting

The financial statements of KPUB have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to governmental units. KPUB uses the economic resources measurement focus and the full accrual method of accounting and follows the Uniform System of Accounts prescribed for public utilities and licensees, as issued by the Federal Energy Regulatory Commission.

In accordance with the Governmental Accounting Standards Board *Codification of Governmental Accounting and Financial Reporting Standards* (the "Codification"), Section P80, KPUB has elected not to apply any statements of the Financial Accounting Standards Board issued after November 30, 1989.

Kerrville Public Utility Board

Notes to Financial Statements

September 30, 2011 and 2010

1. Summary of Significant Accounting Policies (continued)

Electric Revenue and Purchased Power Expense

Revenue from sales of electricity is recognized as billed on a cycle basis with recognition of unbilled revenues at September 30, 2011 and 2010, based upon the meter reading dates for the unbilled portion of each cycle. Rate schedules include power cost adjustment clauses that permit recovery of purchased power costs, not included in base rates, in the month after such costs are incurred. KPUB charges to expense the cost of purchased power in the period of purchase.

Capital Assets

Capital assets purchased from LCRA have been recorded at the original cost of the asset, as recorded by LCRA, offset by a purchase price adjustment. Accumulated depreciation includes amounts recorded by LCRA through the date of acquisition and depreciation since the date of acquisition. Utility plant additions subsequent to the acquisition are recorded at cost. Cost includes the costs of contracted services, direct materials, labor, overhead, and an allowance for borrowed funds used during construction ("AFUDC"). KPUB computes AFUDC using rates representing the cost of borrowed funds on all projects. AFUDC amounted to \$3,217 and \$3,581 for the years ended September 30, 2011 and 2010, respectively. Retirements of utility plant, together with removal costs less salvage, are charged to accumulated depreciation.

To depreciate its investment in the electric plant, KPUB uses a depreciation rate by asset class. The rates for each major asset category ranged from:

Distribution system	1.8% to 5.5%
Building and equipment	2.6% to 4.1%
Transportation equipment	8.3%
Other	3.3% to 8.3%

The straight-line method over the estimated service lives is used to depreciate the various other classes of depreciable property. Rates will be changed, as needed, based upon periodic engineering studies. Depreciation expense, as a percentage of average depreciable plant, was 3.7% and 3.8% for the years ended September 30, 2011 and 2010, respectively.

Restricted and Governing Board Designated Assets

The Reserve Fund and Interest and Sinking Fund were established in accordance with the City ordinance creating KPUB, as well as provisions of the trust indenture executed in conjunction with the issuance of the revenue bonds. The Equipment Replacement Fund and Emergency Repair and Contingency Fund were established by management at the request of the Board of Trustees (the "Board").

Kerrville Public Utility Board

Notes to Financial Statements

September 30, 2011 and 2010

1. Summary of Significant Accounting Policies (continued)

Restricted and Governing Board Designated Assets (continued)

The Interest and Sinking Fund is to be used for the payment of bond principal and interest on all outstanding bonds as those payments come due.

The Reserve Fund is to be used solely to retire the last of any outstanding bonds or to pay principal and interest on any bonds to the extent the amounts in the Interest and Sinking Fund are insufficient for such purposes.

The Equipment Replacement Fund is to be used for unbudgeted construction projects, with a minimum total cost of \$100,000, approved by the Board.

The Emergency Repair and Contingency Fund is to be used for any uninsured loss occurrences, with a minimum total cost of \$100,000, resulting from disasters declared by the Board, whom also are required to approve expenses.

Other Non-Current Assets

Other non-current assets consist principally of revenue bond issuance costs. The revenue bond issuance costs are being amortized over the period during which the revenue bonds are outstanding using the straight-line method.

Statements of Cash Flows

For the statements of cash flows, KPUB considers money market accounts, certificates of deposit, and investments with original maturities of three months or less from the date of acquisition to be cash equivalents. Unrealized gains (losses) relating to the changes in fair value of investments of \$(3,175) and \$(17,090) during the years ended September 30, 2011 and 2010, respectively, are considered non-cash items for the statements of cash flows.

Investments

KPUB invests funds in accordance with its policy, bond indentures, and the Texas Public Funds Investment Act. Investments are carried at fair value based on published net asset values for Texas Local Government Investment Pool ("TexPool") and Local Government Investment Cooperative ("LOGIC"). Fair value is defined as the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Kerrville Public Utility Board

Notes to Financial Statements

September 30, 2011 and 2010

1. Summary of Significant Accounting Policies (continued)

Investments (continued)

Effective October 1, 2010, KPUB adopted Governmental Accounting Standards Board Statement No. 59, *Financial Instruments Omnibus*, which revised the reporting and disclosure for certain types of financial instruments. The adoption of this standard did not have an impact on KPUB's financial statements.

Materials and Supplies Inventory

Inventories are stated at weighted-average cost. On a periodic basis, KPUB compares the amount of inventory on hand with its records to determine whether write-offs for excess or obsolete inventory are required.

Budgets and Budgetary Accounting

KPUB is not legally required to adopt a budget; therefore, comparative statements of actual expenses to budget expenses are not included as required supplementary information.

Contingent Liabilities

KPUB provides for contingent liabilities when it is probable a liability has been incurred and the amount of loss can be reasonably estimated. At September 30, 2011 and 2010, no such liabilities existed.

Risk Management

KPUB is exposed to employee-related risks for health benefits and workers' compensation, as well as to various risks of loss related to torts including theft of, damage to, or destruction of assets, errors and omissions, and natural disasters. KPUB does not participate in a risk pool. KPUB purchases insurance to cover the aforementioned risks. There was no instance in the last three fiscal years that any settlement exceeded insurance coverage. There were no decreases in insurance coverage in 2011 and 2010.

Classification of Operating and Non-Operating Revenue and Expenses

KPUB defines operating revenues and expenses as those revenues and expenses generated by a specified program offering either a good or service. This definition is consistent with the Codification, Section 2450 which defines operating receipts as cash receipts from customers and other cash receipts that do not result from transactions defined as capital and related financing, non-capital financing, or investing activities. Operating expenses include personnel services, contractual services, commodities, other expenses (such as insurance), and depreciation. Revenues and expenses not fitting the above definitions are considered non-operating.

Kerrville Public Utility Board

Notes to Financial Statements

September 30, 2011 and 2010

1. Summary of Significant Accounting Policies (continued)

Use of Estimates

In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the balance sheet and reported revenues and expenses for the period. Actual results could differ significantly from those estimates.

Application of Restricted and Unrestricted Net Assets

KPUB may receive funding from an organization whose expenditure is restricted to certain allowable costs. In situations where both restricted and unrestricted net assets are expended to cover allowable expenses, KPUB will first expend the restricted net assets and cover additional costs with unrestricted net assets. KPUB reserves the right to selectively defer the use of restricted assets.

Pledged Revenues

Net revenues of KPUB have been pledged to the payment of its debt obligations. Net revenues are defined as gross revenues, less maintenance and operation expenses.

2. Cash, Cash Equivalents, and Investments

Cash

KPUB's bank balances totaled approximately \$737,000 as of September 30, 2011 and approximately \$348,000 as of September 30, 2010. All bank balances were either fully insured by the Federal Deposit Insurance Corporation ("FDIC") or collateralized with securities held by KPUB or its agent and listing KPUB as pledgee.

Investments

KPUB's policy regarding credit risk is as follows: Investments are limited pursuant to Texas state law to obligations of the United States government and other agencies or instruments thereof; direct obligations of the state of Texas or its agencies and other political subdivisions; obligations of states, agencies, counties, cities, and other political subdivisions that have an investment rating of not less than A; certificates of deposit; fully collateralized repurchase agreements; certain types of commercial paper; and local government investment pools.

Kerrville Public Utility Board

Notes to Financial Statements

September 30, 2011 and 2010

2. Cash, Cash Equivalents, and Investments (continued)

Investments (continued)

The State Comptroller of Public Accounts exercises oversight responsibility over TexPool. Oversight includes the ability to significantly influence operations, designation of management, and accountability for fiscal matters. Additionally, the State Comptroller has established an advisory board composed both of participants in TexPool and of other persons who do not have a business relationship with TexPool. The Advisory Board members review the investment policy and management fee structure. Finally, TexPool is rated AAAM by Standard & Poor's. Although TexPool is not registered with the Securities and Exchange Commission ("SEC") as an investment company, KPUB believes that TexPool operates as a Rule 2a-7 pool, as described in GASB Statement No. 59. As such, KPUB uses amortized cost to report its investment.

LOGIC is overseen by a five-member board of directors who are elected from its participants. Although LOGIC is not registered with the SEC as an investment company, KPUB believes that LOGIC operates as a Rule 2a-7 pool, as described in GASB Statement No. 59. Accordingly, KPUB uses amortized cost to report its investment. The investment activities of LOGIC are administered by First Southwest Asset Management, Inc. and J.P. Morgan Investment Management, Inc. and is rated AAAM by Standard & Poor's. There is no regulatory oversight by the state of Texas over LOGIC.

Investment Objectives

The primary objectives of KPUB's investment activity are the preservation and safety of principal, and liquidity of the overall portfolio. Each investment transaction shall seek to first ensure that capital losses are avoided, whether they are from securities defaults or erosion of market value. KPUB's investment portfolio will remain sufficiently liquid to meet operating requirements that might be reasonably anticipated. Liquidity shall be achieved by matching investment maturities with forecasted cash flow requirements and by investing the securities with active secondary markets.

Investments shall be made with exercise of judgment and due care under prevailing circumstances, prudence, discretion, and intelligence. Investments shall not be speculative, but will consider the probable safety of their capital, as well as the probable income to be derived.

All participants in the investment process shall seek to act responsibly as custodians of the public trust. Investment officials shall avoid any transaction that might impair public confidence in KPUB. Officers and employees involved in the investment process shall refrain from personal business activity that could conflict with proper execution of the investment program, or which could impair their ability to make impartial investment decisions.

Kerrville Public Utility Board

Notes to Financial Statements

September 30, 2011 and 2010

2. Cash, Cash Equivalents, and Investments (continued)

Investment Objectives (continued)

Interest Rate Risk – As a means of limiting its exposure to fair value losses that could occur from rising interest rates, KPUB’s investment policy limits the maturities of investments and prohibits any investment for speculative gains. The maximum allowable stated maturity of any individual investment owned by KPUB is 10 years. Available funds in KPUB’s Revenue Account, Equipment Replacement Account, and Emergency Repair and Contingency Account are limited to an average maturity not greater than 1 year. Available funds in the Debt Reserve Account are expected to average from 3 to 7 years. Available funds in the Rate Stabilization Account are limited to an average maturity not greater than 90 days.

KPUB recognizes that investment risks can result from market price changes. Investment officers are expected to display prudence, discretion, and intelligence in the selection of securities, as a way to minimize risk. Investments shall not be speculative, but will consider the probable safety of their capital.

The primary objectives of KPUB’s investment activity are the preservation and safety of principal, and KPUB’s exposure to interest rate risk, as measured by the segmented time distribution by investment type, is summarized below:

	September 30, 2011		Investment Maturities in Years	
	Fair Value		Less than 1	1 - 5
Federal Home Loan Bank Note	\$ 1,006,184	\$	1,006,184	\$ -
Total United States Agency Investments	1,006,184		1,006,184	-
Texas Revenue Anticipation Note	1,022,563		1,022,563	-
Texas Local Government Investment Pool (TexPool)	6,952,820		6,952,820	-
Local Government Investment Cooperative (LOGIC)	4,756,395		4,756,395	-
Total investments	\$ 13,737,962	\$	13,737,962	\$ -
	September 30, 2010			
	Fair Value		Less than 1	1 - 5
Federal Farm Credit Bank	\$ 2,040,225	\$	2,040,225	\$ -
Total United States Agency Investments	2,040,225		2,040,225	-
Texas Local Government Investment Pool (TexPool)	10,512,358		10,512,358	-
Local Government Investment Cooperative (LOGIC)	4,747,440		4,747,440	-
Total investments	\$ 17,300,023	\$	17,300,023	\$ -

Kerrville Public Utility Board

Notes to Financial Statements

September 30, 2011 and 2010

2. Cash, Cash Equivalents, and Investments (continued)

Credit Risk

KPUB's exposure to credit risk is presented below by investment category as rated by Standard & Poor's:

	September 30, 2011	
	Fair Value	Rating
Federal Home Loan Bank Note	\$ 1,006,184	AA+
Total United States Agency Investments	1,006,184	
Texas Revenue Anticipation Note	1,022,563	SP1+
Texas Local Government Investment Pool (TexPool)	6,952,820	AAAm
Local Government Investment Cooperative (LOGIC)	4,756,395	AAAm
Total investments	\$ 13,737,962	

	September 30, 2010	
	Fair Value	Rating
Federal Farm Credit Bank	\$ 2,040,225	AAA
Total United States Agency Investments	2,040,225	
Texas Local Government Investment Pool (TexPool)	10,512,358	AAAm
Local Government Investment Cooperative (LOGIC)	4,747,440	AAAm
Total investments	\$ 17,300,023	

Custodial Credit Risk

KPUB's funds on deposit with the depository bank were either fully insured by the FDIC or collateralized with securities held by KPUB or its agent and listing KPUB as pledgee. All KPUB cash deposits at the depository bank were covered at all times by pledged securities held as collateral at the third-party bank.

All investments are made in the name of KPUB. All investments were purchased with the delivery versus payment method and are recorded in KPUB's name on the Federal Reserve's book entry system and confirmed to KPUB via safekeeping receipt maintained on the books of the depository bank's safekeeping department.

Kerrville Public Utility Board

Notes to Financial Statements

September 30, 2011 and 2010

2. Cash, Cash Equivalents, and Investments (continued)

Concentration of Credit Risk

Although KPUB's investment policy does not include an approved asset mix, the investment portfolio is diversified to eliminate the risk of loss resulting from over concentration of assets in a specific maturity, a specific issue, or a specific class of securities. Within the constraints of cash flow requirements, investment maturities are staggered in a way that avoids undue concentration of assets in a specific maturity sector. KPUB does not invest its portfolio in one investment pool. Funds are divided between two pools for diversification and security reasons.

The KPUB investment policy does not list prohibited investments. The policy does list allowable investments, and these include:

- Obligations of the United States or its agencies and instrumentalities, as permitted by Section 2256.009 of the Public Funds Investment Act
- Certificates of deposit or share certificates issued by a depository institution that has its main office or branch office in the state of Texas and (i) are fully insured or collateralized and meeting all further requirements, as set forth in Section 2256.010(a), as amended, Texas Government Code, or (ii) the depository institution participates in the Certificate of Deposit Account Registry Service network and meets all further requirements, as set forth in Section 2256.010(b), Texas Government Code, as amended
- Fully insured or collateralized certificates of deposit issued by state or national banks and savings banks or state or federal credit unions domiciled in the state of Texas meeting all other requirements, as set forth in Section 2256.010, Texas Government Code, as amended
- Repurchase agreements collateralized by obligations of the United States or its agencies and meeting all other requirements, as set forth in Section 2256.011, Texas Government Code, as amended
- Investment pools rated not less than AAA- or an equivalent rating by at least one nationally recognized rating service and meeting all other requirements, as set forth in Section 2256.016, Texas Government Code, as amended, including authorization by KPUB in the particular investment pool
- Other such securities or obligations approved by the Investment Committee and permitted by the Texas Public Funds Investment Act and Bond Ordinance No. 2001-15

The investment policy also allows an eligible securities lending program, which satisfies the requirements of Section 2256.0115 of the Texas Public Funds Investment Act. KPUB did not participate in any security lending agreements during fiscal years 2011 and 2010.

Kerrville Public Utility Board

Notes to Financial Statements

September 30, 2011 and 2010

2. Cash, Cash Equivalents, and Investments (continued)

Concentration of Credit Risk (continued)

As of September 30, 2011 and 2010, the following was the composition of KPUB's investment portfolio:

2011

Local Government Investment Cooperative (LOGIC)	34.62%
Texas Local Government Investment Pool (TexPool)	50.61%
United States Agency Securities	14.77%

2010

Local Government Investment Cooperative (LOGIC)	27.40%
Texas Local Government Investment Pool (TexPool)	60.80%
United States Agency Securities	11.80%

Foreign Currency Risk

KPUB does not engage in any deposit or investment transactions involving foreign currency.

Kerrville Public Utility Board

Notes to Financial Statements

September 30, 2011 and 2010

3. Capital Assets

Capital assets consist of electric plant in service and are comprised of the following components:

	<u>9/30/2010</u>	<u>Increases</u>	<u>Decreases</u>	<u>9/30/2011</u>
Capital asset, not being depreciated:				
Land	\$ 117,656	\$ -	\$ -	\$ 117,656
Construction in progress	1,577,236	3,020,047	(2,149,998)	2,447,285
Total capital assets not being depreciated	<u>1,694,892</u>	<u>3,020,047</u>	<u>(2,149,998)</u>	<u>2,564,941</u>
Capital assets, being depreciated:				
Distribution system	46,454,016	1,367,864	(910,312)	46,911,568
Buildings and equipment	4,112,806	747,939	(230,474)	4,630,271
Transportation equipment	1,599,264	-	-	1,599,264
Other	779,451	53,002	(9,100)	823,353
Total capital assets being depreciated	<u>52,945,537</u>	<u>2,168,805</u>	<u>(1,149,886)</u>	<u>53,964,456</u>
Less accumulated depreciation for:				
Distribution system	(22,648,052)	(1,729,868)	1,001,058	(23,376,862)
Buildings and equipment	(2,478,386)	(134,505)	230,474	(2,382,417)
Transportation equipment	(471,875)	(121,881)	-	(593,756)
Other	(336,275)	(32,452)	9,100	(359,627)
Total accumulated depreciation	<u>(25,934,588)</u>	<u>(2,018,706)</u>	<u>1,240,632</u>	<u>(26,712,662)</u>
Total capital assets, being depreciated, net	<u>27,010,949</u>	<u>150,099</u>	<u>90,746</u>	<u>27,251,794</u>
Capital assets, net	<u>\$ 28,705,841</u>	<u>\$ 3,170,146</u>	<u>\$ (2,059,252)</u>	<u>\$ 29,816,735</u>

Kerrville Public Utility Board

Notes to Financial Statements

September 30, 2011 and 2010

3. Capital Assets (continued)

	9/30/2009	Increases	Decreases	9/30/2010
Capital asset, not being depreciated:				
Land	\$ 117,656	\$ -	\$ -	\$ 117,656
Construction in progress	1,055,916	2,251,781	(1,730,461)	1,577,236
Total capital assets not being depreciated	1,173,572	2,251,781	(1,730,461)	1,694,892
Capital assets, being depreciated:				
Distribution system	45,414,057	1,549,123	(509,164)	46,454,016
Buildings and equipment	4,068,935	83,056	(39,185)	4,112,806
Transportation equipment	1,648,126	155,694	(204,556)	1,599,264
Other	766,361	13,090	-	779,451
Total capital assets being depreciated	51,897,479	1,800,963	(752,905)	52,945,537
Less accumulated depreciation for:				
Distribution system	(21,180,484)	(1,906,928)	439,360	(22,648,052)
Buildings and equipment	(2,392,594)	(124,977)	39,185	(2,478,386)
Transportation equipment	(569,387)	(107,044)	204,556	(471,875)
Other	(307,694)	(28,581)	-	(336,275)
Total accumulated depreciation	(24,450,159)	(2,167,530)	683,101	(25,934,588)
Total capital assets, being depreciated, net	27,447,320	(366,567)	(69,804)	27,010,949
Capital assets, net	\$ 28,620,892	\$ 1,885,214	\$ (1,800,265)	\$ 28,705,841

Kerrville Public Utility Board

Notes to Financial Statements

September 30, 2011 and 2010

4. Long-Term Debt

Revenue bonds are comprised of the following:

	September 30,	
	2011	2010
City of Kerrville, Texas Electric System Revenue Refunding Bonds, Series 2001; due in annual installments in amounts ranging from \$2,085,000 to \$2,415,000 through November 1, 2013; interest ranges from 5.125% to 5.25% payable semiannually	\$ 6,775,000	\$ 8,970,000
Net unamortized premium	179,216	265,240
Unamortized loss on refunding	(213,561)	(316,070)
Net revenue bonds	6,740,655	8,919,170
Less current portion	2,295,000	2,195,000
	\$ 4,445,655	\$ 6,724,170

The principal balance of long-term debt was \$11,055,000 on October 1, 2009, and KPUB made principal payments of \$2,195,000 and \$2,085,000 during 2011 and 2010, respectively, resulting in a remaining principal balance of long-term debt of \$6,775,000 and \$8,970,000 at September 30, 2011 and 2010, respectively. The unamortized premiums and unamortized loss on refunding are amortized on the straight-line basis over the remaining life of the Series 2001 Bond Issue. Amortization of the unamortized loss on refunding to expense was \$102,509 and \$102,510 in the years ended September 30, 2011 and 2010, respectively. Amortization of the premium to expense was \$(86,024) for each of the years ended September 30, 2011 and 2010.

The Reserve Fund must contain cash and/or investments equal to or exceeding the average annual principal and interest requirements. The bond resolution and ordinances contain flow of funds requirements which generally provide for the order in which funds are to be applied and a specific debt service coverage requirement of net revenues at least equal to 110% of the principal and interest requirements due. As of September 30, 2011 and 2010, bond reserve and debt service coverage requirements have been met.

Kerrville Public Utility Board

Notes to Financial Statements

September 30, 2011 and 2010

4. Long-Term Debt (continued)

A schedule of bond maturities and interest through 2014 is as follows:

<u>Fiscal Year Ending</u>	<u>Total</u>	<u>Interest</u>	<u>Principal</u>	<u>Balance of Principal Outstanding</u>
2011				\$ 6,775,000
2012	\$ 2,589,009	\$ 294,009	\$ 2,295,000	4,480,000
2013	2,586,806	171,806	2,415,000	2,065,000
2014	<u>2,119,206</u>	<u>54,206</u>	<u>2,065,000</u>	-
	<u>\$ 7,295,021</u>	<u>\$ 520,021</u>	<u>\$ 6,775,000</u>	

5. Related Party Transactions

Pursuant to the bond ordinance, KPUB pays the City 3% of the gross revenues of the System on a monthly basis. Such City fees, which are recorded as non-operating expenses, amounted to \$1,418,611 and \$1,216,898 for the years ended September 30, 2011 and 2010, respectively. At September 30, 2011 and 2010, amounts due to the City by KPUB amounted to \$123,340 and 111,657, respectively. In addition, KPUB pays a discretionary fee to the City considered on an annual basis which is used for economic development. This discretionary fee amounted to \$25,000 in 2011 and \$25,000 in 2010.

6. Purchased Power Contract

Pursuant to the purchase of the System from LCRA in December 1987, KPUB entered into an agreement with LCRA for the purchase of power. In early 1988, the wholesale power agreement was amended. The amended wholesale power agreement provides that LCRA will supply electric power and energy to KPUB for its use and for resale to customers of the System. The minimum term of the amended agreement is through June 2016 and is renewable for successive periods of ten years thereafter, unless notice of intent to terminate is given by either party prior to the end of the eighth year of the original or any successive term. Under the terms of the amended agreement, KPUB agrees not to enter into a contract for power and energy with any other entity without prior approval of LCRA. KPUB may, however, purchase from others any portion of its electric and power requirements which cannot be supplied by LCRA. The LCRA, through its Price Select Program, offers all LCRA customers the option of buying 10% of their energy from alternate power providers. A second option is also provided which allows customers to buy other customers' 10% options and use the additional contracts to increase the amount of energy that could be bought from alternate power suppliers.

Kerrville Public Utility Board

Notes to Financial Statements

September 30, 2011 and 2010

6. Purchased Power Contract (continued)

In December 2005, KPUB revised its agreement with LCRA that included, among other provisions, that the contract load would be established at 80 MW for KPUB.

KPUB entered into a contract with City Public Service of San Antonio ("CPS Energy") for the energy above the LCRA 80 MW contract cap. The contract was for energy during the months of June, July, August, and September 2006.

Power supply issues for the fiscal year 2007 continued to be expanded for the future of the LCRA contract with the 80 MW cap and management entering into two aggregation groups for the purchases outside LCRA. KPUB is operating under a partial requirements contract with LCRA, with LCRA providing a large percentage of the KPUB's energy and KPUB going out for bids for the remainder of the energy required.

The aggregation group of nine which includes Boerne, NBU, San Bernard Electric Cooperative, the Cities of Georgetown and Seguin, Guadalupe Valley Electric Cooperative, Bandera Electric Cooperative, Central Texas Electric Cooperative, and KPUB went out for bid in 2007 for their 10% energy. This bid resulted in the aggregation entering into a three-year contract with CPS Energy. KPUB received 19 MW, 19 MW, and 16 MW of energy under this contract for fiscal years 2010, 2009, and 2008, respectively.

KPUB then entered into another aggregation contract with Central Texas Electric Cooperative and the City of Georgetown. This second group was able to acquire the 10% contract loads of Bastrop, Cap Rock Energy, Cuero, Hallettsville, Flatonia, Fredericksburg, Goldthwaite, Lampasas, Llano, Mason, San Marcos, and San Saba. For fiscal years 2010 and 2009, this energy totaled 19.2 MW and resulted in 6.4 MW for each of the three aggregated systems, through June 24, 2010 when the term ended. This energy was bid and awarded to CPS Energy for fiscal years 2010 and 2009.

To competitively assess the energy requirement for fiscal years 2011, 2010, and 2009, KPUB went out for bids and selected CPS Energy for the energy above the cap.

At a Special Called Meeting on October 13, 2010, the Kerrville Public Utility Board of Trustees unanimously passed Resolution 10-20 providing notice to the LCRA to terminate the Wholesale Power Agreement, effective June 25, 2016. Prior to this decision, management solicited wholesale power proposals by issuing a Request for Proposal on June 16, 2010. A total of 43 proposals were received from 17 different suppliers. From these proposals, on September 21, 2011, KPUB selected CPS Energy to be its major power supplier effective June 25, 2016. The agreement is for an initial term of 7 1/2 years with an option for a 3-year extension. Under the terms of the agreement, CPS Energy will supply 15 MW of KPUB's 35 MW of base load and KPUB's entire load following requirements. CPS energy will supply 10% of KPUB's energy from renewable power sources beginning in calendar year 2017 and that level will increase each year to a maximum of 15% in calendar year 2023. Under a separate agreement, CPS Energy will supply KPUB's Qualified Scheduling Entity services in the ERCOT market.

Kerrville Public Utility Board

Notes to Financial Statements

September 30, 2011 and 2010

6. Purchased Power Contract (continued)

KPUB will still be receiving power from LCRA through its GenTex agreement that provides KPUB with 4.1% of the capacity and energy from the Lost Pines Power Project Unit 1. This will account for approximately 10 MW of KPUB's base load and the agreement continues through the operational life of the plant. KPUB will continue to monitor pricing offers in the ERCOT market and will issue a subsequent Request for Proposal for the 10 MW remainder of its base load at a future date.

7. Retirement Plan

KPUB provides pension benefits for all of its full-time employees through a non-traditional, joint contributory, hybrid defined benefit plan (the "Plan") in the state-wide Texas Municipal Retirement System ("TMRS"), an agent multiple-employer public employee retirement system. The Plan provisions that have been adopted by KPUB are within the options available in the governing state statutes of TMRS. TMRS issues a publicly available CAFR for all plans in the aggregate on a calendar year basis. The CAFR includes financial statements and required supplementary information for TMRS; the report also provides detailed explanations of the contributions, benefits, and actuarial methods and assumptions used by TMRS. This report may be obtained by writing to TMRS at P.O. Box 149153, Austin, Texas 78714-9153 or by calling 800-924-8677. In addition, the report is available on TMRS' web site at www.TMRS.com.

Benefits depend upon the sum of the employee's contributions to the Plan, with interest, and KPUB-financed monetary credits, with interest. At the date the Plan began, KPUB granted monetary credits for service rendered before the Plan began of a theoretical amount equal to two times what would have been contributed by the employee, with interest, prior to establishment of the Plan. Monetary credits for service since the Plan began are a percent (100%, 150%, or 200%) of the employee's accumulated contributions. In addition, KPUB can grant as often as annually, another type of monetary credit referred to as an updated service credit which is a theoretical amount which, when added to the employee's accumulated contributions and the monetary credits for service since the Plan began, would be the total monetary credits and employee contributions accumulated with interest if the current employee contribution rate and KPUB matching percent had always been in existence and if the employee's salary had always been the average of his/her salary in the last three years that are one year before the effective date.

Kerrville Public Utility Board

Notes to Financial Statements

September 30, 2011 and 2010

7. Retirement Plan (continued)

At retirement, the benefit is calculated as if the sum of the employee's accumulated contributions with interest and the employer-financed monetary credits with interest were used to purchase an annuity. Members can retire at ages 60 and above with 5 or more years of service, or with 25 years of service regardless of age. The Plan provisions are adopted by the governing body of KPUB, within the options available in the state statutes governing TMRS and within the actuarial constraints also in the statutes.

Contributions

The contribution rate for the employees is 7%, and KPUB's matching ratio is currently 2 to 1, both as adopted by the governing body of KPUB. Under the state law governing TMRS, the actuary annually determines KPUB's contribution rate. This rate consists of the normal cost contribution rate and the prior service cost contribution rate, both of which are calculated to be a level percent of payroll from year to year. The normal cost contribution rate finances the currently accruing monetary credits due to KPUB's matching percent, which are the obligation of KPUB as of an employee's retirement date, not at the time the employee's contributions are made. The normal cost contribution rate is the actuarially determined percent of payroll necessary to satisfy the obligation of KPUB to each employee at the time his or her retirement becomes effective. The prior service contribution rate amortizes the unfunded actuarial liability over the remainder of the Plan's 27.5-year amortization period. When KPUB periodically adopts updated service credits and increases in annuities in effect, the increased unfunded actuarial liability is to be amortized over a new 27.5-year amortization period. Currently, the unfunded actuarial liability is being amortized over the 27.5-year period which began January 1997. The unit credit actuarial cost method is used for determining KPUB's contribution rate. Both the employees and KPUB make contributions monthly. Since KPUB needs to know its contribution rate in advance to budget for it, there is a one-year lag between the actuarial valuation that is the basis for the rate and the calendar year when the rate goes into effect.

KPUB's total payroll in fiscal years 2011 and 2010 was approximately \$3,474,000 and \$3,242,000, respectively, and KPUB's contributions were based on that amount. KPUB's annual pension cost was \$497,546, \$450,148, and \$389,391, respectively, for the fiscal years ended September 30, 2011, 2010, 2009, and was equal to KPUB's required and actual contributions. KPUB has no net pension obligation.

KPUB made the required contributions, which represents normal cost contribution and amortization of the unfunded actuarial liability (14.48% of covered payroll for the months in calendar year 2011, 9.49% normal cost plus 4.99% to amortize the unfunded actuarial liability; 13.92% of covered payroll for the months in calendar year 2010, 8.98% normal cost plus 4.94% to amortize the unfunded actuarial liability; and 13.80% of covered payroll for the months in calendar year 2009, 9.39% normal cost plus 4.41% to amortize the unfunded actuarial liability).

Kerrville Public Utility Board

Notes to Financial Statements

September 30, 2011 and 2010

7. Retirement Plan (continued)

Contributions (continued)

The actuarial cost method and significant assumptions underlying the actuarial calculations are as follows:

Summary of Actuarial Methods and Significant Assumptions

Valuation date	December 31, 2010
Actuary cost method	Projected unit credit
Asset valuation basis	10-year smoothed market
Inflation rate	3.0%
Projected annual salary increase	Varies by age and service
Cost of living adjustment	2.1%
Investment return assumption	7.0%
Amortization method	Level percent of payroll
Remaining amortization period	27.5 years – closed period
Amortization period for new gains/losses	30 years

As of December 31, 2010, the most recent actuarial valuation date, the Plan was 92.2% funded. The actuarial accrued liability for benefits was \$16,530,195, and the actuarial value of assets was \$15,239,390, resulting in an unfunded actuarial accrued liability (“UAAL”) of \$1,290,805. The covered payroll was \$3,291,182, and the ratio for the UAAL to the covered payroll was 39.2%.

The schedule of funding progress, presented as Required Supplementary Information following the notes to financial statements, 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 of benefits.

8. Supplemental Death Benefits Plan

KPUB also participates in the cost sharing multiple-employer defined benefit group-term life insurance plan operated by TMRS known as the Supplemental Death Benefits Funds (“SDBF”). KPUB elected, by ordinance, to provide group-term life insurance coverage to both current and retired employees for plan years ended December 31, 2011 and December 31, 2010. KPUB may terminate coverage under and discontinue participation in the SDBF by adopting an ordinance before November 1 of any year to be effective the following January 1.

Kerrville Public Utility Board

Notes to Financial Statements

September 30, 2011 and 2010

8. Supplemental Death Benefits Plan (continued)

The death benefit for active employees provides a lump-sum payment approximately equal to the employee's annual salary (calculated based on the employee's actual earnings, for the 12-month period preceding the month of death); retired employees are insured for \$7,500: this coverage is an "other postemployment benefit," or OPEB.

Contributions

KPUB contributes to the SDBF at a contractually required rate, as determined by an annual actuarial valuation. The rate is equal to the cost of providing one-year term life insurance. The funding policy for the SDBF program is to assure adequate resources are available to meet all death benefit payments for the upcoming year; the intent is not to pre-fund retiree term life insurance during employees' entire careers.

KPUB's contributions to the TMRS SDBF for the fiscal years ended 2011, 2010, and 2009 were \$8,361, \$6,795, and \$7,773, respectively, which equaled the required contributions each year.

Schedule of Contribution Rates
(Retiree-Only Portion of the Rate)

Plan/Calendar Year	Annual Required Contribution ("ARC") (Rate)	Actual Contributions Made (Rate)	Actual Contributions Made (Dollars)	Percentage of ARC Contributed
2009	0.26%	0.26%	7,742	100%
2010	0.19%	0.19%	5,690	100%
2011	0.26%	0.26%	8,021	100%

Kerrville Public Utility Board

Notes to Financial Statements

September 30, 2011 and 2010

9. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities balances are comprised of the following:

	2011	2010
Accrued interest	\$ 147,008	\$ 193,880
Accrued vacation	167,515	133,451
Accrued payroll	66,348	215,185
Accrued City fees	123,340	111,657
Sales tax payable	107,756	72,263
Miscellaneous payables	442,557	390,666
	\$ 1,054,524	\$ 1,117,102

Required Supplementary Information

Kerrville Public Utility Board

Required Supplementary Information

September 30, 2011

Required supplementary information, as determined by TMRS, is as follows:

Schedule of Funding Progress – Unaudited

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability	Percentage Funded (1)/(2)	Unfunded Actuarial Liability	Annual Covered Payroll	UAAL Divided by (4)/(5)
	(1)	(2)	(3)	(4)	(5)	(6)
Dec. 31, 2010	\$ 15,239,390	\$ 16,530,195	92.2%	\$ 1,290,805	\$ 3,291,182	39.2%
Dec. 31, 2009	10,156,946	12,566,934	80.8%	2,409,988	2,977,687	80.9%
Dec. 31, 2008	8,986,430	11,256,605	79.8%	2,270,175	2,805,990	80.9%