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March 21, 2007

Sara Kyle, Chairman  
Tennessee Regulatory Authority  
460 James Robertson Pkwy  
Nashville, TN 37243-0505

**Re: *Application of Bristol Tennessee Essential Services for a Certificate of Convenience and Necessity to Provide Competing Telecommunications Services***  
**Docket number: 05-00251**

Dear Chairman Kyle:

Bristol Tennessee Essential Services ("BTES") submits its 2006 Comprehensive Financial Report for filing.

Very truly yours,

BOULT, CUMMINGS, CONNERS & BERRY, PLC

By:

Henry Walker

HW/djc

Enclosure

cc: Edward Phillips  
Guy Hicks  
Charles B. Welch, Jr.

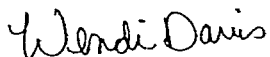
# Comprehensive Annual Financial Report

Bristol Tennessee Essential Services  
(A Self-Supporting Enterprise Fund of the  
City of Bristol, Tennessee)

*Year ended June 30, 2006*

Prepared by:

Accounting and Finance Department and General Manager



Wendi Davis  
Director of Accounting and Finance



R. Michael Browder  
General Manager

# Bristol Tennessee Essential Services Comprehensive Annual Financial Report

Year ended June 30, 2006

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December 20, 2006

To the Chairman and Members of  
the Board of Directors of Bristol Tennessee  
Essential Services

### **Letter of Transmittal**

The Comprehensive Annual Financial Report (“CAFR”) of Bristol Tennessee Essential Services (“BTES”), a self-supporting governmental enterprise fund of the City of Bristol, Tennessee operated under the general supervision and control of a five-member Board of Directors as per Chapter 32 Public Acts of Tennessee 1935, for the fiscal year ended June 30, 2006, is submitted herewith.

The CAFR was compiled by the staff of the Accounting and Finance Department with the close cooperation of our independent auditor. It represents the official report of BTES' financial operations and conditions to the citizens, the Board of Directors, BTES management, rating agencies and other interested parties.

Responsibility for the accuracy of the presented data and the completeness and fairness of the presentation, including all disclosures, rests with BTES. We believe the data, as presented, are accurate in all material respects and are presented in a manner designed to fairly set forth the financial position and results of operations and cash flows of BTES.

All disclosures necessary for the reader to gain a thorough understanding of BTES' financial condition have been included.

In order to meet the needs of a broad spectrum of financial statement readers, the CAFR is presented in four sections:

- Introductory Section
- Financial Section
- Statistical Section
- Internal Control and Compliance Section

The **Introductory Section** includes the table of contents, this transmittal letter, an organizational chart of BTES, BTES' general philosophy, background of BTES and a brief recap of fiscal year 2006.

The **Financial Section** is composed of the report of independent auditors; Management Discussion and Analysis (“MD&A”), including a narrative introduction, financial overview and financial analysis; and the financial statements. This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The notes to the financial statements are considered an integral and essential part of adequate disclosure and fair presentation of the financial statements.

## Letter of Transmittal (continued)

The **Statistical Section** includes selected financial and demographic trend information. The tables within this section differ from certain information in the financial section in that they represent some non-accounting data covering ten fiscal years. These data were accumulated through BTES statistical collection.

The **Internal Control and Compliance Section** includes the independent auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*.

The accompanying financial statements present the financial position, results of operations and cash flows of BTES, in accordance with the requirements of the Governmental Accounting Standards Board ("GASB").

This report does not include the financial activities of the City of Bristol, Tennessee. Financial reports are available directly from the City of Bristol, Tennessee.

Bristol, Tennessee is located in the northeastern portion of the state. It is one of three cities in Sullivan County, with the other two being Kingsport and Bluff City. The population of Sullivan County is 153,050. Its industrial base is primarily manufacturing, followed by the service sector and agriculture.

Because of its central location in the eastern United States, Bristol is within 600 miles of approximately 53% of the population of the United States. Interstate 81 passes through the city. Bristol is part of the metropolitan statistical area ("MSA") of Bristol, Johnson City and Kingsport, commonly called the Tri-Cities MSA. With a population of over 490,238 people, the Tri-Cities MSA is 111th largest in the United States.

Bristol benefits from the state's high ranking in Alexander Grant and Company's GENERAL MANUFACTURING CLIMATES, which ranks Tennessee near the top in the nation as a place for manufacturing.

Bristol is a good place to work and live, with the following amenities:

- Excellent health care facilities
- Seven Tennessee Valley Authority lakes with 2,200 miles of shoreline
- Five national parks
- Bristol Motor Speedway (Two NASCAR dates per year with over 160,000 seats)
- Low crime rate
- Four distinct seasons
- Excellent schools
- Nine colleges and universities (Degrees ranging from Art to Medicine)
- Seven beautiful golf courses

Bristol and the surrounding areas continue to grow and prosper. Eastman Chemical Company is headquartered in Sullivan County. Exide's Super Battery Plant is in Bristol where they build and charge over 33,000 batteries per day. Several facilities have expanded this year. Touchstone Wireless moved most of their operation from their Blackley Road facility to the former Wal Mart facility located on West State Street. This expansion allowed them to hire 125 new employees. Royal Mouldings, the largest marketer and manufacturer of decorative polymer moldings in the United States is also expanding. They are currently constructing another 250,000 square feet to their existing 150,000-square-foot building located in the Bristol Industrial Park. This expansion will create 80 new jobs. Bristol Metals, L.P. has also expanded their X-Ray facility and plans on adding additional employees in the future.

## Letter of Transmittal (continued)

### FINANCIAL INFORMATION

#### *BTES AS AN ENTERPRISE FUND*

BTES operates under an independent Board of Directors as an enterprise fund of the City of Bristol, Tennessee. This being the case, BTES funds its expenditures through its rates and charges and receives no income from City taxes. BTES establishes rates annually to provide for anticipated cash outlays for operating expenses and capital improvement requirements.

#### *ACCOUNTING SYSTEM AND BUDGETARY CONTROL*

BTES' financial accounting system is based on accounting principles generally accepted in the United States of America. Internal accounting controls are an integral part of BTES' accounting process and are designed to provide reasonable, but not absolute, assurance that assets are safeguarded from unauthorized use or disposition and that records used for preparing financial statements and maintaining asset accountability are reliable.

BTES applies Financial Accounting Standards Board ("FASB") pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, in which case, GASB prevails. Consistent with other public utility enterprise funds, BTES has elected not to adopt the FASB Statements and Interpretations issued after November 30, 1989, in accordance with GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting."

BTES' Board of Directors approves BTES' annual budget for its recommended rate, expenses and capital outlays. An analysis of revenue and operating expenses for the year ended June 30, 2006, is provided in the Financial Section of this report.

#### *PLANT*

Plant is stated at cost, which includes cost of contract work, labor, materials and allocated indirect charges. Major renewals and betterments are capitalized, while minor replacements and repairs are expensed as incurred. Property, plant and equipment are depreciated using the straight-line method at rates which will amortize costs over the estimated useful lives of the assets. The provision for depreciation does not include depreciation on transportation equipment per Federal Energy Regulatory Commission Guidelines. Those amounts are reported as operation expenses in the Statements of Revenues, Expenses and Changes in Net Assets. The cost of plant retired, together with removal costs less salvage, is charged to accumulated depreciation when property is removed from service.

#### *CASH MANAGEMENT*

BTES' moneys are deposited in banks insured by the FDIC. Investments permitted include obligations of the U.S. Treasury and U.S. agencies and certificates of deposit. Temporary investments, consisting entirely of certificates of deposit, are stated at cost which approximates fair value. The cash management performance for the year ended June 30, 2006, produced interest earnings of \$1,376,507.

## Letter of Transmittal (continued)

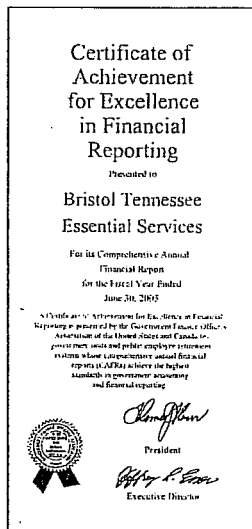
### RISK MANAGEMENT

BTES' assets are protected through a third party insurance provider. Through this provider, coverage is provided for workers' compensation, comprehensive, general and automobile liability, auto physical damage, crime and fiduciary, errors and omissions, property, boiler and machinery and pollution. BTES has not experienced a loss in excess of insurance coverage in any of the past three fiscal years.

### INDEPENDENT AUDIT

BTES has an annual audit performed by independent certified public accountants. The firm of Coulter & Justus, P. C., was selected by the Board of Directors. The auditor's report on the financial statements is included in the Financial Section of this report.

### AWARDS



For the first time, the Government Finance Officers Association ("GFOA") awarded a Certificate of Achievement for Excellence in Financial Reporting to BTES for its CAFR for the fiscal year ended June 30, 1997. BTES was also awarded the certificate for its CAFR for the fiscal years ended June 30, 1998, 1999, 2000, 2001, 2002, 2003, 2004 and 2005. To qualify for this prestigious award, BTES issued an easily readable and efficiently organized CAFR. In addition, this report satisfied both accounting principles generally accepted in the United States of America and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our present report continues to meet the program's requirements, and we are submitting it to the GFOA to determine eligibility for another certificate.

### ACKNOWLEDGMENTS

The preparation of this report could not have been accomplished without the staff of the Accounting and Finance Department. We express our sincere appreciation to those who assisted and contributed to its preparation.

Sincere appreciation is also expressed to Sam Coulter, CPA, Ricky Jackson, CPA, Adam Allen, CPA, and the staff at Coulter & Justus, P.C., for assistance throughout the year pertaining to various financial matters and for their assistance in the preparation of this report.

In closing, we would like to thank the members of the Board of Directors of Bristol Tennessee Essential Services for their interest and support in planning and conducting the operations of BTES in a responsible and progressive manner.

Respectfully submitted,

*Wendi Davis*

Wendi Davis  
Director of Accounting and Finance

*R. Michael Browder*

R. Michael Browder  
Chief Executive Officer

## BACKGROUND INFORMATION

On June 30, 1945, the Tennessee Valley Authority (TVA) purchased the properties of East Tennessee Light and Power Company. Bristol Tennessee Electric System, now called Bristol Tennessee Essential Services (BTES), was started July 1, 1945 as a result of a referendum in which the citizens of Bristol, Tennessee voted to purchase from TVA a portion of these properties. A \$1.3 million issue of Electric Light and Power bonds was required to finance the transaction. BTES immediately agreed to terms of a 20-year power contract for TVA to supply power which BTES distributed to the public at substantially lower rates.

As per Chapter 32 Public Acts of Tennessee 1935 and the contract with TVA, a five-member board of directors was established by the city to have general supervision and control of the municipally-owned electric system with one member serving from City Council. Current board members include Chairman Patrick W. Hickie, Jr., CPA, Vice-Chairman Bryan K. Boyd, Pereda R. "Pete" Paty, J. Scott MacMorran and City Council Representative David K. Shumaker.

The International Brotherhood of Electrical Workers (IBEW) has represented the trades and crafts employees since prior to TVA purchasing the system from East Tennessee Light and Power.

Sixty BTES employees serve over 32,000 customers in Bristol and Sullivan County in Tennessee and a portion of Washington County, Virginia - approximately 280 square miles of service area.

BTES purchases electric power from TVA, the nation's largest public power generator of electricity. Our customers pay approximately 6.9 cents per kilowatt hour, while the national average is 8.9 cents per kilowatt hour. BTES has had seven rate reductions since June 1982 with the most recent in October 1997. This does not include changes in wholesale power costs from TVA. In October 2003, TVA added an environmental charge to their rate to cover the cost of certain air pollution equipment. This effectively raised the rates for all residential customers by 6% and small general power customers by 7%. TVA's rate increase in October 2005, raised rates for our residential customers by 6.67%, for our small general power customers by 6.25% and for our large general power customers by 7.26%. TVA's rate increase in April 2006, raised rates for our residential customers by 8.92%, for our small general power customers by 8.39% and for our large general power customers by 9.656%.

The electricity we purchase from TVA is delivered at 161,000 volts to our two delivery points- Bluff City Primary and Blountville Primary Substations. We step it down to 69,000 volts for subtransmission to other substations and to 13,200/7620 volts for distribution. In some cases, small distribution substations provide additional voltage reduction to large general power loads. The voltage entering a customer's home is 120/240 volts which is utilized for lighting, heating and operating household appliances. Businesses and industries may be served at 208/120, 480/277, 4160/2400 volts or other standard voltages.



## BACKGROUND INFORMATION (continued)

In 1994, BTES received the American Public Power Association's prestigious E. F. Scattergood System Achievement Award for outstanding achievement by a utility.

Also in 1994, BTES was one of three organizations to receive the Tennessee Quality Governor's Award, now called the Tennessee Center for Performance Excellence *Award of Excellence*, presented by Governor Ned McWherter. The other two recipients were Nissan and FedEx. Other organizations that have received this prestigious award include: Eastman Chemical Company, Philips Consumer Electronics Company, Bridgestone/Firestone Company, Eaton Corporation, Methodist Medical Center of Oak Ridge, Baptist Health Systems of Knoxville, Fleetguard, Caterpillar Financial Services, Memphis Light, Gas and Water, Eaton Aeroquip, Pal's Sudden Service, Tennessee Valley Authority Nuclear, John Deere Power Products and Mountain States Health Alliance.

In June 1996, BTES received the American Public Power Association's Golden Tree Award in recognition of BTES planting over one tree per customer

In June 1997, BTES received the American Public Power Association's Community Service Award for outstanding civic and community involvement by our employees.

In October 1997, Chief Executive Officer R. Michael Browder received the 1997 Jim Spradley Award for individual accomplishments in the field of industrial and economic development in Tennessee that go above and beyond the requirements of the vocation for which they are compensated. The award was presented by Governor Don Sundquist at the Governor's Economic Summit in Nashville.

In May 2000, Chief Executive Officer R. Michael Browder received the Tennessee Valley Public Power Association's Distinguished Service Award for his exceptional performance and contributions toward the accomplishment of the organization's goals.

From July 2001 until June 2002, Chief Executive Officer R. Michael Browder served as Chairman of the Board of the American Public Power Association.

In October 2004, BTES received approval to offer cable television and Internet service.

On December 15, 2004, the BTES Board of Directors changed the name of the organization from *Bristol Tennessee Electric System* to *Bristol Tennessee Essential Services* to reflect the new services being offered.

In February 2005, BTES received the National Arbor Day Foundation Tree Line USA Award for the sixth year in a row in recognition of quality tree care, annual worker training, tree planting and public education.

In fall 2005, BTES began providing cable television and Internet service.

For fiscal year 2005, BTES received the Government Finance Officers Association *Certificate of Achievement for Excellence in Financial Reporting* for the eighth year in a row.

In March 2006, BTES received approval from the Tennessee Regulatory Authority to provide telephone service.

## RECAP OF FISCAL YEAR 2006

During the past year major engineering and construction projects included three-phase reconductor jobs on DeVault Bridge Road, Buffalo Road and D. Droke Road; a two-phase reconductor job on Cleveland Road and a single-phase reconductor job on Rooty Branch Road and Seneker Lane. We replaced control houses at Industrial, Pemberton and Ruthton Substations to be able to add fiber optic equipment. We added a second three-phase circuit, automatic switchgear and a new back-up generator at the BTES Service Center.

We installed over 42,000 feet of underground primary conductors to serve the following subdivisions and developments: Serenity Ridge, The Reserve II, Bowwoods Townhouse Complex Phase I, Mountain Breeze, Woodlyn, Charlton Place Condominiums, Raceday Center, Pole Position Campground, BMS RV Campground and All American Campground.

Approximately 5.5 miles of fiber optic cable were installed, completing the 120-mile fiber optic backbone system, to provide the interconnection of substations to the BTES Service Center. Fiber optic cable is lightning resistant, if not lightning proof. This, along with the reliability and speed of the fiber optic cable, greatly enhances the Supervisory Control and Data Acquisition System (SCADA) functionality to substations.

During the fiscal year 2006, we installed 260 miles of our fiber optic distribution system to provide greater reliability for our customers using ONTs to automatically report customer outages and to begin reading meters remotely.

BTES continued to utilize the PORCHE system which integrates with the customer data base to increase the level of customer service when reporting power outages. During the fiscal year 2006, BTES integrated the use of the fiber optic system ONTs to automatically detect and report outages of power, cable television and Internet.

BTES began installation of cable and Internet in November 2005. By the end of fiscal year 2006, BTES had served 1,460 homes and businesses with cable and/or Internet service.

Our outage time per customer was 48 minutes for calendar year 2005 which gives us a reliability index of 99.991%, an all-time low for BTES.

During the last five years, we have been able to maintain our goal of a five-year tree clearance cycle. We continue to monitor frequency of tree-caused outages by areas and make more frequent visits to these areas. In 2005-2006, we cleared trees along feeder lines at Shelby Substation circuits 394, 374, 384, 354 and 3014; Steele Creek Substation circuits 214 and 224; Vance Substation circuits 264, 234 and 254 and Bluff City Substation circuits 264, 214 and 274.

Our goal is to maintain the distribution transformer capacity ratio to 200 percent of peak demand or less. We continue to work to improve this number. We will continue our transformer loading program to help us predict new customer demand needs. The transformer loading program assists us in identifying transformers that we will investigate for being heavily loaded and change if necessary.

## RECAP OF FISCAL YEAR 2006 (continued)

During our routine substation preventative maintenance program, we discovered potential problems and made repairs to relay problems at Adams Chapel Substation and regulator problems at Adams Chapel, Buffalo, Pemberton, Medical Center, Carden Hollow and Bluff City District Substations.

We checked 69 three-phase meter installations, finding all to be okay.

Twenty-five problems ranging from minor to critical were discovered and repaired during our annual infrared inspection.

As the city's largest taxpayer, we paid the maximum in-lieu-of-tax payments as provided by Tennessee State Law and the TVA Contract to the City of Bristol in the amount of \$732,072 for fiscal year 2006. Combined with taxes paid to Sullivan County, Tennessee, Bluff City Tennessee and Washington County, Virginia, a grand total of \$946,566 was paid by BTES.

We planted 99 dogwoods during the fiscal year 2006 through our Trade-A-Tree program.

The initial installation of an electronic mapping system is complete. We are using Global Positioning System (GPS) data collected by Atlantic Engineering Group (AEG) to enter the geographic location of all power system features such as poles, transformers, meters and lines into the BTES mapping system. The mapping platform will operate as a Geographical Information System (GIS) that will link BTES customer and facility data to the geographical symbols on the maps. A base map consisting of roads and property parcels is being used along with aerial photographs of the BTES service area. After the field data has been collected on all of the power system facilities, the new electronic maps will replace the existing paper mapping system.

Our bad debts, as a percentage of retail revenue, are 0.17 percent for the fiscal year 2006, which is well below our stated goal of 0.25 percent. The industry target is 0.4 percent. This has been accomplished in a variety of ways. We diligently work to prevent customers from falling too far behind in paying their bill. We thoroughly screen new applications to determine inclination to pay. In an effort to help those in need find necessary funding, we work with area churches, the Salvation Army, United Way, the Upper East Tennessee Human Development Agency and other customers via our *Help Your Neighbor* program. Our deposit procedure seems to be working well. Residential customers who demonstrate a history of paying their bills in a timely manner may have their deposit waived. A general power customer with a calculated standard deposit of \$10,000 or less, which has a principal owner who has lived in our service area five or more years with good pay and credit history and is willing to guarantee the account, may have the deposit reduced or waived. To date, no adverse effects have been detected.

We have been prepaying our power bill. Under this arrangement, we use an automated clearing house to send our money to TVA before actual payment is due. In return, we receive interest payments from TVA for the amount of their cost of short-term borrowing. This is used when TVA's rate is higher than we are able to receive through other investment vehicles.

## **RECAP OF FISCAL YEAR 2006 (continued)**

In December 2002, we purchased \$8 million of Discounted Energy Units from TVA. Our participation in the program will assure a long-term supply of power at a low price and increase our return on investments. Our power bill is being discounted by the principle and interest earned.

Efforts to increase sales of electricity continued. Efforts are ongoing to increase the use of electric heat pumps and electric water heaters, especially load-managed water heaters that can be switched off during peak-demand periods. During calendar year 2005, we inspected 267 heat pump installations and installed 589 water heaters. BTES has over 13,600 load-managed water heaters. During calendar year 2005, TVA paid us \$812,501 for the ability to cycle these water heaters off during peak times. Twenty loans were made through the Energy Savings Loan Program at a total of \$94,975. Advertising, direct involvement with customers through our Homebuilders Association Spring Home Show and communicating through our customer newsletter, BTES News, continues to help add growth in these areas.

We issued 30-year Electric Revenue Bonds in the amount of \$23,910,000 for capital expenses and to pre-purchase power from TVA.

We continue to make subdivision development agreements available to developers. Instead of initially collecting the total cost for electric facilities installed to serve subdivisions, we offer to waive all or part of these costs for developers who agree to have all-electric homes with inspected heat pumps and load-managed water heaters built in their developments. Total costs are charged for any lots on which homes are built that are not all-electric. We presently have 865 lots in 28 subdivisions covered under this type agreement.

Each customer who purchases a BTES water heater or who has an inspected electric heat pump installed is surveyed by mail. The surveys are used to monitor quality and customer satisfaction of the program and satisfaction with BTES employees and Quality Contractor Network employees.

For the 15th consecutive year, in cooperation with the Bristol Chamber of Commerce; the City of Bristol, Tennessee and NETWORKS - Sullivan Partnership, we maintained the Governor's Three-Star Community Economic Preparedness Program Award, which signifies that Bristol has the organization, attitude, facilities and skills to attract and retain industry. A major component of this certification is having available property for industrial development. The Bristol Industrial Park purchased by BTES provides this component.

In calendar year 2005, BTES personnel visited 81 existing industries to discuss electrical needs, expansion possibilities and their satisfaction with the service they are receiving. BTES worked with the City of Bristol, Tennessee; State of Tennessee; TVA and NETWORKS - Sullivan Partnership to identify and assist 10 businesses with expansions or relocations to the Bristol area, resulting in the potential for 225 new jobs.

## **RECAP OF FISCAL YEAR 2006 (continued)**

Our Help Your Neighbor program was conducted successfully for the 14th year to assist residential electric customers in paying their winter electric bills during difficult times. This year \$12,132 was contributed by customers and BTES' match, providing assistance for over 100 families. As in the past, the need of the customer is identified by the Salvation Army and funds are administered by the United Way.

Sixty-one percent of our employees had perfect attendance for calendar year 2005.

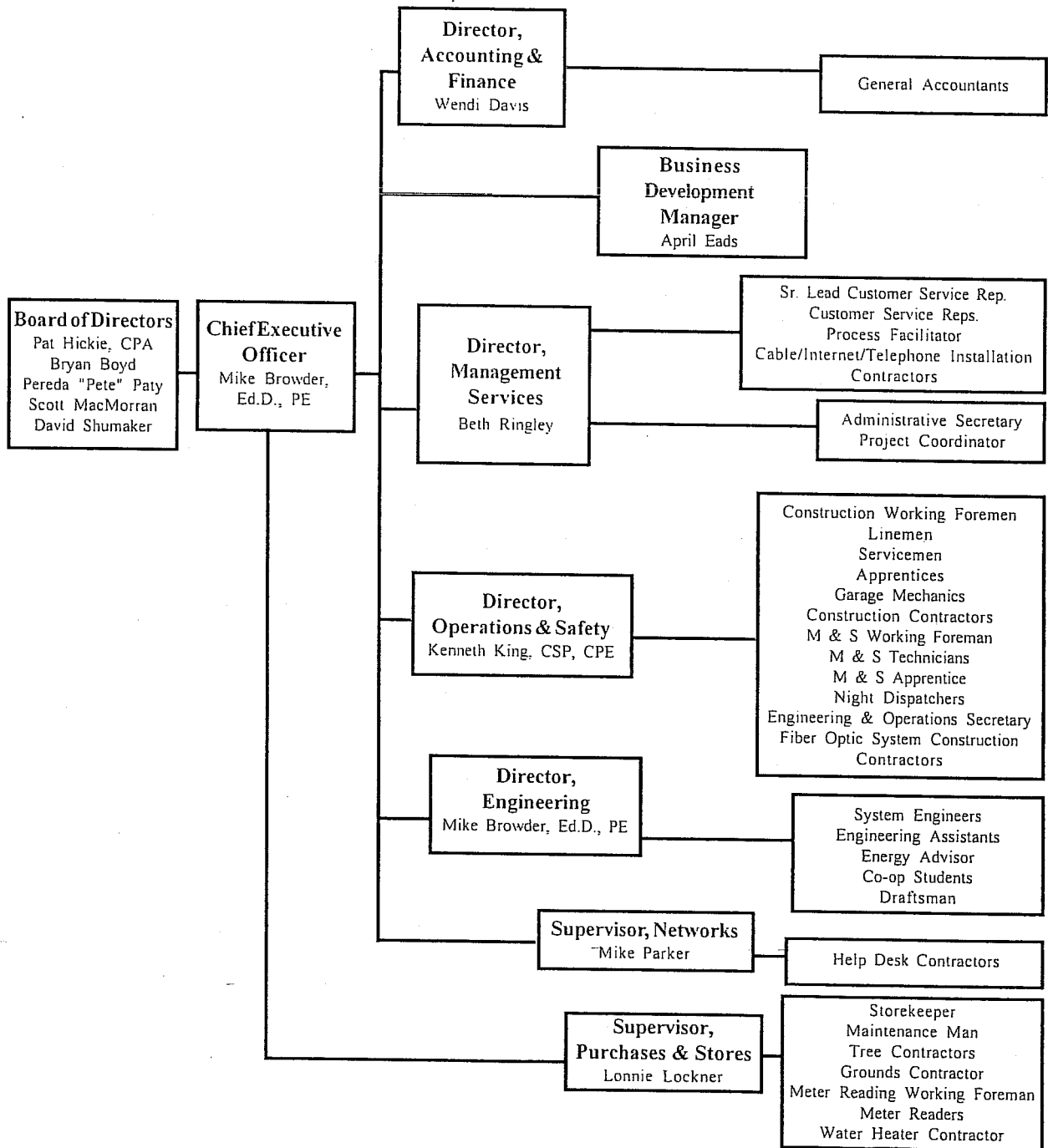
For the 23rd consecutive year, we had no lost-time accidents with a total of over 3.1 million man-hours since the last lost-time accident in 1982.

During calendar year 2005, six full-time employees left BTES. This prompted organizational changes and the hiring of three new full-time employees. We continued a co-op program for electrical engineering students.

We presented 28 awards at our annual heat pump dinner for Quality Contractor Network members.

At the annual Service Awards Banquet, we presented awards representing 70 years of service including: two employees for 25 years of service, one employee for 10 years of service and two employees for 5 years of service to BTES and three recognition awards for new employees.

# BTES Organizational Chart



## General Philosophy

### ■ *Reliability For Our Customers Is Essential*

The customer is our reason for being and ultimately judges the quality of our service. We must provide safe, reliable, cost-effective service and properly allocate costs for BTES to survive, grow and meet the needs of our present and future customers.

### ■ *BTES Employees Are Our Most Important Asset*

They provide the intelligence and determine the reputation of our organization. They are respected as valuable teamworkers striving to meet our goals of quality service. We are committed to providing a safe and healthy workplace for all BTES employees who are the driving force behind all we do.

### ■ *Resources Must Be Wisely Allocated And Used*

Our resources (time, money, facilities and equipment) must be wisely allocated, utilized and invested to enable us to provide quality service at reasonable long-term rates.

### ■ *Our Vendors And Suppliers Are Our Partners*

They provide goods and services that enable us to meet the needs of our customers. We will treat our vendors and suppliers with respect and create an environment which will ensure mutual success.

### ■ *Increasing Sales Helps Keep Rates Down*

We are committed to increasing sales by developing additional load such as residential heat pumps, water heaters and industrial and commercial loads. We will promote the use of BTES Internet, Telephone and Cable Television. This will help provide us a broader base to divide expenses which helps keep rates down.

### ■ *Safety, Conservation And Efficient Use Of Our Services*

We must provide a customer communication program through all area news media, school and civic programs, direct mail, in-house seminars and trade shows in order to educate and assist customers in the safety, conservation and efficient use of electricity, Internet, Telephone and Cable Television.

### ■ *Planning Is Vital To Achievement*

To achieve our objectives at BTES, it is necessary that we clearly understand our plans, objectives and strategies as we strive to maintain our excellence in service.

### ■ *Continuous Improvement Is The Key To Long-Term Success*

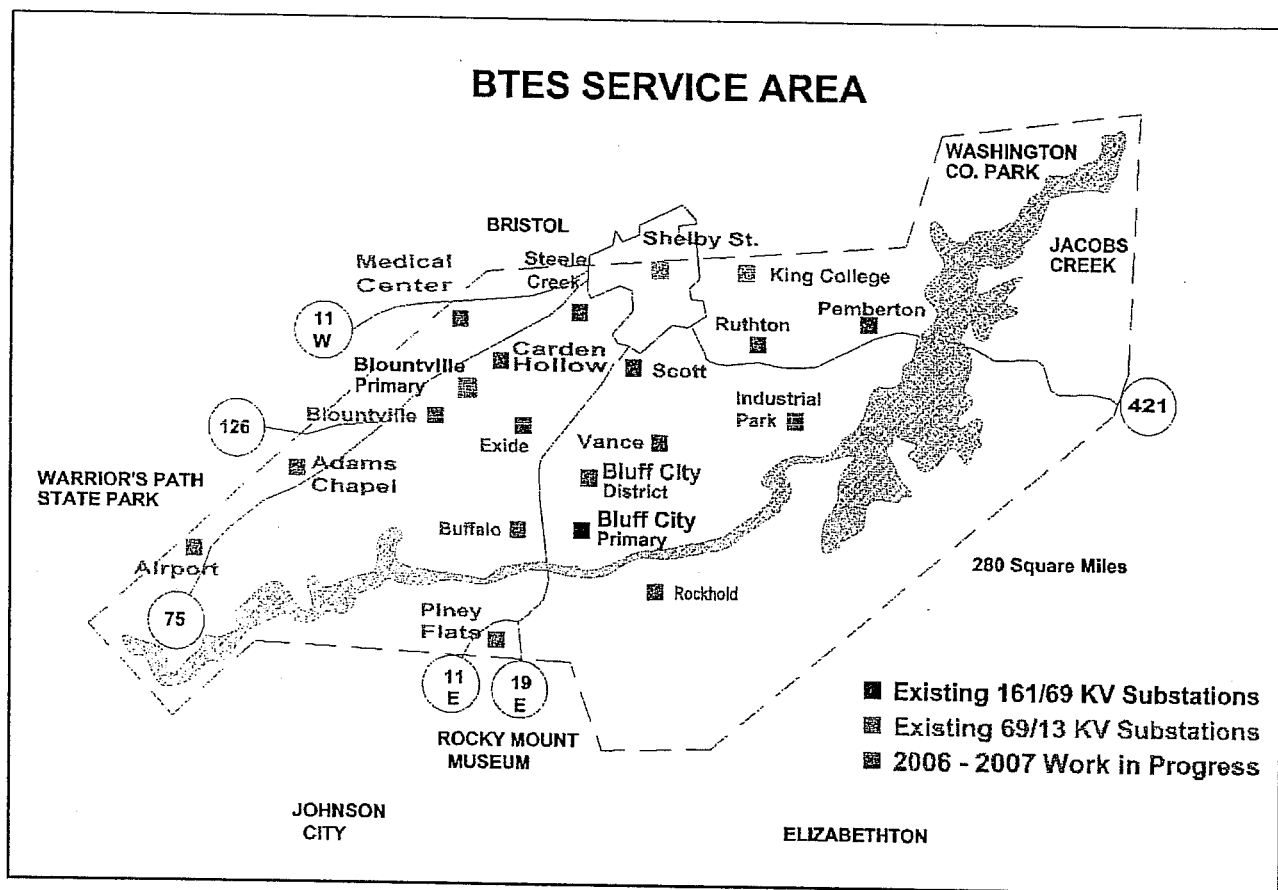
We must continually strive for excellence and quality in everything we do - in our workmanship and services, the appearance and safety of our workplace, human relations and our commitment to our community and ourselves.

### ■ *We Want To Earn And Deserve The Trust And Respect Of Our Customers*

The customer entrusts his family's welfare to us to provide his electrical power, cable television, Internet and telephone needs. He must have complete confidence in the quality service we provide and the people who work for us.

### ■ *A Positive Image Is A Valuable Asset*

We strongly believe in a professional image, and we will strive to maintain such an image in the eyes of our customers, vendors and business associates to improve the quality of life in our community.



### Substations Owned and Operated by BTES

Bluff City Primary	*161/69 KV	200 MVA
Blountville Primary	*161/69 KV	200 MVA
Adams Chapel	69/13 KV	20 MVA
Airport	69/13 KV	20 MVA
Blountville	69/13 KV	25 MVA
Bluff City	69/13 KV	50 MVA
Buffalo	69/13 KV	20 MVA
Carden Hollow	69/13 KV	20 MVA
Exide	69/13 KV	40 MVA
Industrial Park	69/13 KV	20 MVA
King College	69/13 KV	20 MVA
Medical Center	69/13 KV	20 MVA
Pemberton	69/13 KV	20 MVA
Piney Flats	69/13 KV	20 MVA
Scott	69/13 KV	20 MVA
Shelby Street	69/13 KV	80 MVA
Steele Creek	69/13 KV	20 MVA
Ruthton	69/13 KV	10 MVA
Vance	69/13 KV	25 MVA

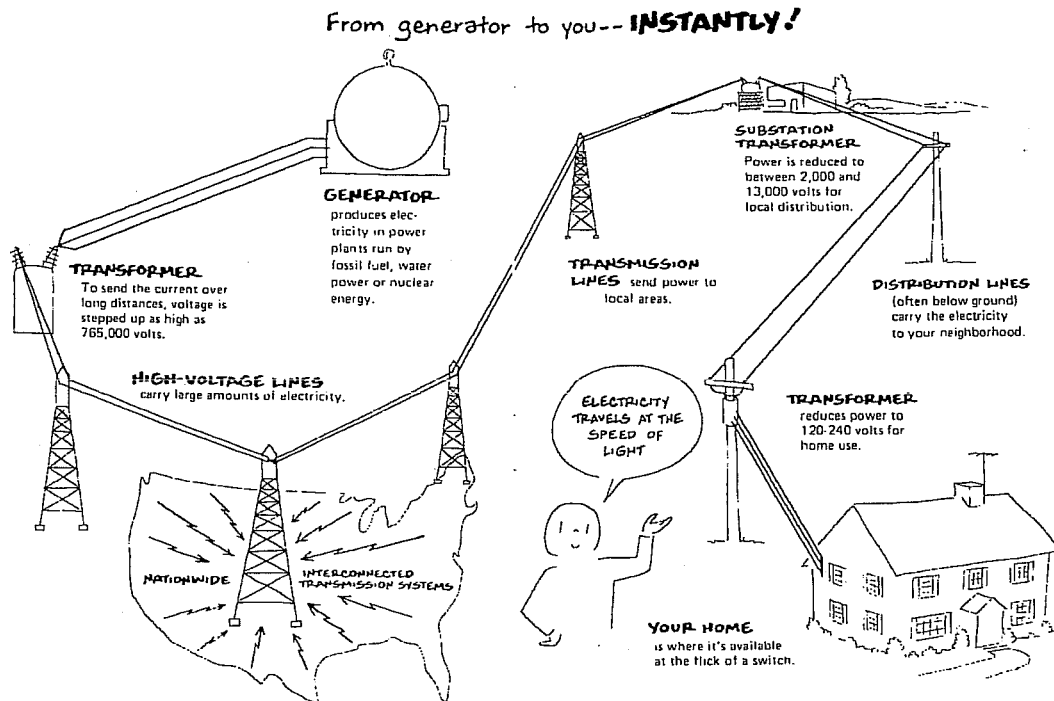
\*Delivery Point from TVA

#### Substations in the 2006-2007 Work Plan

Rockhold	69/13 KV	20 MVA
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## Electric Utility Terms



**Air-Source Heat Pump** - A system that can supply both space heating and cooling. In the heating cycle, the heat pump removes heat from the outside air and pumps it indoors. When cooling, the heat pump absorbs heat from the indoors and rejects it to the outside.

**Ampere** - Unit of measurement of electric current. It's proportional to the quantity of electrons flowing through a conductor past a given point in one second.

**Base Load** - The minimum load over a given period of time.

**Blackout** - A temporary loss of electricity in an area because of failure of generation or transmission equipment.

**Brownout** - A voltage reduction during an electrical shortage that causes conditions such as dim lights.

**Bus** - An electrical conductor which serves as a common connection for two or more electrical circuits.

**Capacity** - The load for which a generating unit, generating station or other electrical apparatus is rated by the user or the manufacturer.

**Circuit Breaker** - A switch that opens an electric circuit when a short occurs.

**Conductor** - Any substance, usually metallic, that will carry electricity.

**Degree Day** - A unit measuring the extent to which the average daily temperature varies from a standard reference temperature. Based on a reference temperature of 65 degrees Fahrenheit, if the average temperature (high plus low divided by 2) for a day is 70, then there are five cooling degree days for that day. Likewise, if the average temperature was 60, then there were five heating degree days. This historical information can be used for forecasting system load and planning unit maintenance outages, to name a few.

## Electric Utility Terms (continued)

**Delivery Point** - The point, usually a substation, to which electricity is transmitted from its generating sources.

**Demand** - The rate at which electric energy is delivered to a system. The primary source of demand is the power consuming equipment of the customers.

**Depreciation** - Charges made against income to equitably distribute the cost of the decrease in plant value during the period when services are obtained from use of the facilities. The decrease in plant value is caused by wear, deterioration or obsolescence.

**Deregulation** - Movement of an industry from one of monopolistic entities or environments to one free market enterprise; in the electric industry this involves elimination of service area and rate restrictions and obligation to serve; results in distributor choice of supplier and eventually customer choice of supplier.

**Dispatching** - The control of an electric system involving switching substations, transmission/distribution lines and other equipment. Monitoring and operating the SCADA system. Dispatching crews for emergencies and maintaining a log of work locations and purpose for outside crews.

**Distribution System** - A system that enables delivering electric energy at 2.4 kV to 25 kV from convenient points (substations) on the transmission system to the customers.

**Earth Coupled Heat Pump** - An efficient electrical device that heats or cools by moving heat into or out of a building. It uses an antifreeze solution or refrigerant in a pipe buried in the ground to collect or disperse heat. Also called geothermal system, ground source heat pump or water source heat pump.

**Easement** - A right obtained from property owners that allows utility companies to construct, operate, maintain, and control facilities such as transmission lines on the property.

**Eminent Domain** - The right of government to take, or to authorize the taking of, private property for public use, just compensation usually being given to the owner.

**Electric Current** - The flow of electric charge in a conductor between two points having a difference in potential, generally expressed in amperes.

**Electric and Magnetic Fields (EMF)** - Radiation surrounding conductors that carry electricity - present wherever electric power is being used.

**Fault** - A point of defect in an electric circuit that prevents the current from following the intended course.

**Insulator** - A non conductor, usually of glass or porcelain, for insulating and supporting electric wires.

**Kilowatt** - The basic unit of electric demand, equal to 1,000 watts - average household demand is 10 to 20 kilowatts.

**Kilowatt Hour** - A unit of energy or work equal to 1,000 watt-hours. The basic measure of electric energy generation or use. A 100-watt light bulb burning for 10 hours uses one kilowatt hour.

**Load** - The amount of electric power delivered or required at any specified point on a system. Load originates at the power consuming equipment of the customers.

## Electric Utility Terms (continued)

**Load Factor** - The ratio of the average load in kilowatts supplied during a designated period to the peak load in kilowatts occurring in that period.

**Load Management** - A program used by an electric utility to control its customers' use of electricity during times when their demand for electricity is high. Can involve reducing voltage or cutting off air conditioners or water heaters for short periods by remote control.

**Losses** - Power (kilowatts) and energy (kilowatt hours) lost during the operation of an electric system. Losses occur principally when energy is transformed into waste heat in conductors and other electrical apparatus.

**Megawatt** - 1,000 kilowatts or 1,000,000 watts.

**Megawatt Hour** - 1,000 kilowatt hours.

**Peak Demand** - The maximum rate at which electric energy is delivered to or by a system during a specific period of time.

**Power Factor** - The ratio of real power (kilowatts) to apparent power (kilovolt-amperes) for any given load and time.

**Power Theft** - Tampering with a meter to lower electric bills which is a dangerous and illegal act.

**Ratchet** - An electric rate charge based on the exceptional load of a seasonal peak in respect to the other seasons.

**SCADA** - Supervisory Control Data Acquisition System - Through a master station comprised of the equipment and computer software, SCADA provides instantaneous substation monitoring and control in addition to complete system status such as electric load, voltage levels and interruptions of service. Data also includes system kilowatt hours, amperage on each feeder phase, voltage on each phase, substation kilowatt hours and instantaneous kilowatt demand by substation or transformer bank. It includes data used for system planning, emergency switching and system maintenance.

**Substation** - An assemblage of equipment that enables switching and/or changing or regulating the voltage of electricity.

**Transformer** - A device to change the voltage of alternating current electricity.

**Transmission System** - The system that transports electric energy in bulk form - usually in high voltage - from a source of supply to the distribution systems or other major parts of the electric system.

**Volt** - The force when steadily applied to a circuit having a resistance of one ohm, will produce a current of one ampere.

**Watt** - The electrical unit of power or the rate of doing work. The rate of energy transfer equivalent to one ampere flowing under a pressure of one volt at unity power factor. One horsepower is equivalent to approximately 746 watts.

## Deregulation Dictionary

The following are terms that you may encounter when reading about upcoming deregulation in the electric utilities industry.

**Access Charge** - a charge levied on a power supplier, or its customer, for access to a utility's transmission or distribution system. It is a charge for the right to send electricity over another's wires.

**Aggregator** - an entity that combines the needs of several smaller customers into a larger block of power in order to get a better price.

**Capacity** - the amount of electricity for which a generating plant or transmission system is rated.

**Commercial Customer** - non-manufacturing business customer.

**Customer Choice** - allows retail customers to select the power supplier or generator they buy electricity from.

**Demand** - the amount of power a customer takes at a given moment.

**Direct Access** - the ability of an electric end-user to connect directly with a power supplier, thus bypassing its local utility.

**Distribution System** - local delivery system of electricity to the retail customer's home or business through distribution lines. BTES is a distribution system.

**Electric Cooperative** - a member-owned electric utility company that distributes electricity on a nonprofit basis. Example: Mountain Electric Cooperative.

**Federal Energy Regulatory Commission (FERC)** - the agency that has jurisdiction over natural gas pricing, hydroelectric licensing, oil pipeline rates and gas pipeline certification.

**Generation Company (genco)** - an entity that operates electricity-generating plants. The genco may own the generation plants or interact with short-term marketers on behalf of plant owners.

**Independent Power Producer (IPP)** - a private entity that generates electricity and sells it to other businesses, including utilities.

**Independent System Operator (ISO)** - the independent operator of a transmission system, responsible for guaranteeing open access, scheduling, system reliability and accounting.

**Industrial Customer** - business customer engaged in manufacturing.

**Investor-owned Utility (IOU)** - a stockholder-owned power company that generates and distributes electric energy for profit. Example: American Electric Power.

**Municipal** - electric distribution system owned by a city to provide service for its residents. Example: BTES.

**Non-power Services** - includes such services as gas, home security and telecommunications.

**Power Marketer** - an entity that provides bulk wholesale power for use at a specific place and time. The marketer may or may not generate the power. Example: Cinergy.

## **Deregulation Dictionary (continued)**

**Regional Transmission Organization (RTO)** - FERC Order 2000 requires all investor-owned utilities to consider joining a RTO.

**Retail Wheeling** - a system in which individual retail electric customers are allowed to choose their electric supplier. Also known as retail competition.

**Service Area** - the geographic region that a utility is required to serve, or has the exclusive right to serve, in supplying electricity to the ultimate consumer.

**Stranded Costs** - costs of a utility that have already been legitimately and prudently incurred that are not economically viable in a competitive market.

**Tennessee Valley Authority** - generation and transmission company supplying power to 158 electric utilities in a seven-state region including Tennessee.

**Transmission System** - all the lines, poles and other equipment used to move bulk electricity from a generating plant to a distribution system.

**Unbundling** - separating the costs of operations of generation, transmission and distribution of electricity. An unbundled electric bill would list all costs associated with providing electricity to the consumer.

**Wheeling** - transmitting bulk electricity from a generating plant to a distribution system across a third system's lines.

**Wheeling Charge** - an amount charged to an electric system by another for the transmission of energy to and from another system.

**Wholesale Customer** - a power purchaser that buys for resale to retail customers. Example: BTES.

*Source: Tennessee Magazine*



## Report of Independent Auditors

Board of Directors  
Bristol Tennessee Essential Services

We have audited the accompanying balance sheets of Bristol Tennessee Essential Services ("BTES"), formerly Bristol Tennessee Electric System, an enterprise fund of the City of Bristol, Tennessee, as of June 30, 2006 and 2005, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of BTES' 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audits 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 audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only BTES and do not purport to, and do not, present fairly the financial position of the City of Bristol, Tennessee, as of June 30, 2006 and 2005, and the changes in its financial position, or, where applicable its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Bristol Tennessee Essential Services at June 30, 2006 and 2005, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 20, 2006, on our consideration of BTES' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



Board of Directors  
Bristol Tennessee Essential Services

The Management's Discussion and Analysis on pages 3 through 10 is not a required part of the 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 measurements and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The other supplementary information listed in the introductory and statistical sections of the accompanying table of contents is presented for purposes of additional analysis and is not a required part of the financial statements of BTES. Such information has not been subjected to the auditing procedures applied in our audit of the financial statements and, accordingly, we express no opinion on it.

*Coulter & Justus, P.C.*

October 20, 2006

# Bristol Tennessee Essential Services

## Management's Discussion and Analysis

**June 30, 2006**

This discussion and analysis is intended to be an introduction to the financial statements and notes that follow this section and should be read in conjunction with them. This section will provide narrative discussion and analysis of the financial activities of BTES. The financial performance of BTES is discussed and analyzed within the context of the accompanying financial statements and disclosures following this section. The Introductory Section covers management's letter of transmittal and other BTES information.

### Financial Statement Overview

The financial statements herein are comprised of the Balance Sheets, the Statements of Revenues, Expenses and Changes in Net Assets, the Statements of Cash Flows and the accompanying Notes to Financial Statements.

BTES is a self-supporting enterprise fund of the City of Bristol, Tennessee operated under the general supervision and control of a five-member Board of Directors as per Chapter 32 Public Acts of Tennessee 1935. BTES issues a comprehensive annual financial report which is incorporated in the City's comprehensive annual financial report.

### Operating Highlights

#### Net Assets and Capital Assets

As indicated in Table 1, net assets were \$63,583,229 in 2006, compared to \$61,487,547 in 2005, and \$58,411,545 in 2004. Approximately 53% of the 2006 net assets are invested in capital assets, net of related debt. All remaining net assets are unrestricted and can be used for on-going operations of BTES, although the Board of Directors has established a renewal and replacement fund totaling \$8,000,000 for future construction, improvements and extensions of BTES.

**Table 1**

Bristol Tennessee Essential Services Condensed Balance Sheets			
June 30,			
	2006	2005	2004
Current and other assets	\$ 49,321,114	\$ 35,969,356	\$ 33,241,589
Capital assets	46,705,185	34,025,791	31,895,221
Total assets	96,026,299	69,995,147	65,136,810
Current liabilities	8,095,791	8,507,600	6,725,265
Bonds Payable	24,347,279	-	-
Total liabilities	32,443,070	8,507,600	6,725,265
Net assets:			
Invested in capital assets, net of related debt	33,878,572	34,025,791	31,895,221
Unrestricted	29,704,657	27,461,756	26,516,324
Total net assets	\$ 63,583,229	\$ 61,487,547	\$ 58,411,545



## Management's Discussion and Analysis (continued)

As indicated in Table 2, during the year gross capital assets increased by \$14,598,098 or 20%. BTES continues the installation of the fiber optic cable system in order to establish a communication link with all substations, provide for automatic outage reporting and remote meter reading capabilities. Note in Table 3 that the net increase in plant in 2006 was 5.4% as compared to 1.4% in 2005. Construction work in progress increased from \$8,004,376 in 2005 to \$19,117,810 in 2006 with the additional installation of BTES' fiber to the home system. Refer to the notes of the audited financial statements for more information regarding capital assets.

**Table 2**

Bristol Tennessee Essential Services – Capital Assets				
	June 30 2006	Net of Accumulated Depreciation	June 30 2005	Net of Accumulated Depreciation
<b>Transmission Plant</b>				
Land and land rights	\$ 94,696	\$ 94,696	\$ 94,696	\$ 94,696
Station equipment	2,823,269	1,448,393	2,823,269	1,561,210
<b>Total Transmission Plant</b>	2,917,965	1,543,089	2,917,965	1,655,906
<b>Distribution Plant</b>				
Land & land rights	855,111	855,111	855,111	855,111
Structures & improvements	862,741	193,687	857,291	216,270
Station equipment	11,333,797	2,992,010	11,333,797	3,219,139
Poles, towers, and fixtures	12,006,819	3,947,248	12,004,452	4,343,974
Overhead conductors and devices	6,621,428	3,162,293	6,635,842	3,350,465
Underground conduit	1,085,280	348,191	1,081,141	362,946
Underground conductors and devices	3,371,319	690,303	3,358,563	801,055
Line transformers	11,455,911	5,708,617	11,223,128	5,731,896
Services	2,922,568	972,999	2,893,745	1,020,759
Meters	2,826,280	1,341,977	2,689,971	1,288,245
Installation on customers' premises	965,595	(66,972)	959,302	(8,419)
Street lighting and signal systems	2,896,974	358,930	2,895,667	534,152
<b>Total Distribution Plant</b>	57,203,823	20,504,394	56,788,010	21,715,593
<b>General Plant</b>				
Land and land rights	101,831	101,831	101,831	101,831
Structures and Improvements	1,158,943	593,679	1,158,943	601,550
Office Furniture and Equipment	421,372	182,827	387,411	155,223
Transportation Equipment	1,929,997	400,017	1,947,756	482,226
Stores Equipment	24,143	5,530	24,143	6,765
Tools, shop, and garage equipments	131,389	10,132	131,389	10,132
Laboratory equipment	104,035	5,965	104,035	5,965
Power operated equipment	104,946	10,204	104,946	10,204
Communication equipment	3,546,233	3,250,575	494,085	297,388
Miscellaneous equipment	43,407	3,652	43,407	3,652
<b>Total General Plant</b>	7,566,296	4,564,412	4,497,946	1,674,936
<b>Total Plant in Service</b>	67,688,084	26,611,895	64,203,920	25,046,435
Construction work in progress	19,117,810	19,117,810	8,004,376	8,004,376
Non-utility property	975,480	975,480	974,980	974,980
<b>Total Capital Assets All Sources</b>	<b>\$ 87,781,374</b>	<b>\$ 46,705,185</b>	<b>\$ 73,183,276</b>	<b>\$ 34,025,791</b>

## Management's Discussion and Analysis (continued)

**Table 3**

Bristol Tennessee Essential Services Changes to Plant in Service Years ended June 30,		
	2006	2005
Plant in service beginning	\$ 64,203,920	\$ 63,306,772
Increases	3,533,666	1,064,023
Decreases	49,502	166,875
Plant in service ending	<u>\$ 67,688,084</u>	<u>\$ 64,203,920</u>

Note: Plant in service does not include non-utility property or construction work in progress.

### Results of Operations

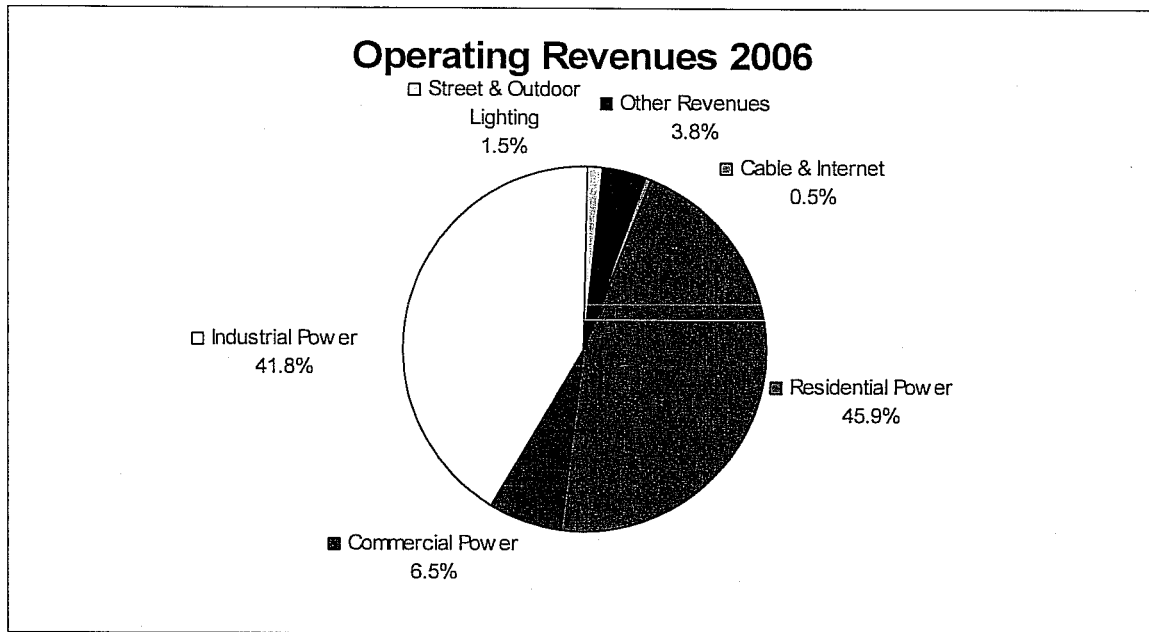
As indicated in Table 4, net assets of BTES increased by \$2,095,682 from fiscal year 2005 to 2006 and increased by \$3,076,002 from fiscal year 2004 to 2005. Operating revenues were principally derived from retail sales of electricity. Operating revenues were \$66,729,254 in 2006 as compared to \$57,323,729 in 2005, and \$57,758,354 in 2004; resulting in a 16.4% increase from 2005 to 2006 and a 0.8% decrease from 2004 to 2005. Temperature throughout the year has historically been a main driver of electric sales, however, during the current fiscal year there were two rate increases in purchase power and related power revenues. Electric operating revenues are characterized in four major customer class types: residential, commercial, industrial and street and outdoor lighting, plus other revenue. In 2006 cable and Internet revenue was added as a form of operating revenue. In 2006, cable and Internet is also included as operating revenue. The percentage of total operating revenue by category has stayed consistent from 2004 to 2006 except for the addition of revenue from the Cable and Internet Business Unit in 2006. See Figures 1, 2 and 3. As shown in Table 4, the internal tax equivalent payments made to the City of Bristol, Tennessee are reported as transfers. Fiscal year 2006 includes two rate increases for purchased power and electric revenue. In October 2003, rate were increases resulting in the first rate change since 1998.

**Table 4**

Bristol Tennessee Essential Services Condensed Statement of Revenues, Expenses and Changes in Net Assets Years ended June 30,			
	2006	2005	2004
Revenues:			
Operating revenues	\$ 66,729,254	\$ 57,323,729	\$ 57,758,354
Non-operating revenues	997,881	892,961	628,270
Total revenues	<u>67,727,135</u>	<u>58,216,690</u>	<u>58,386,624</u>
Expenses:			
Purchased power	56,367,935	47,006,165	48,328,235
Cable Programming	70,721	-	-
Operation expenses	2,830,415	2,829,462	2,742,670
Maintenance	2,750,187	2,559,977	2,364,557
Depreciation	2,024,190	1,937,812	1,897,728
Tax equivalents	238,009	214,494	212,113
Social security taxes	228,588	224,130	206,462
Interest exp on customer deposits	16,608	7,502	6,612
Amortization of bond issue costs	11,582	-	-
Total expenses	<u>64,538,235</u>	<u>54,779,542</u>	<u>56,028,377</u>
Transfers out – tax equivalents to City of Bristol	(1,093,218)	(361,146)	(700,020)
Changes in Net Assets	<u>2,095,682</u>	<u>3,076,002</u>	<u>1,658,227</u>
Beginning net assets	61,487,547	58,411,545	56,753,318
Ending net assets	<u>\$ 63,583,229</u>	<u>\$ 61,487,547</u>	<u>\$ 58,411,545</u>

## Management's Discussion and Analysis (continued)

**Figure 1**



**Figure 2**

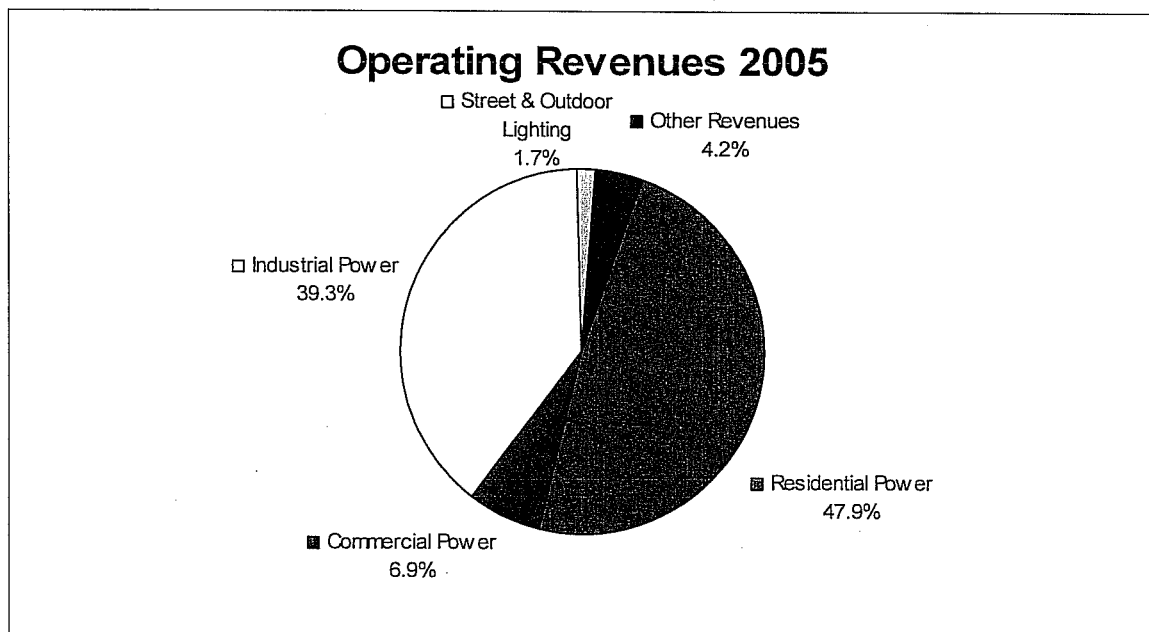
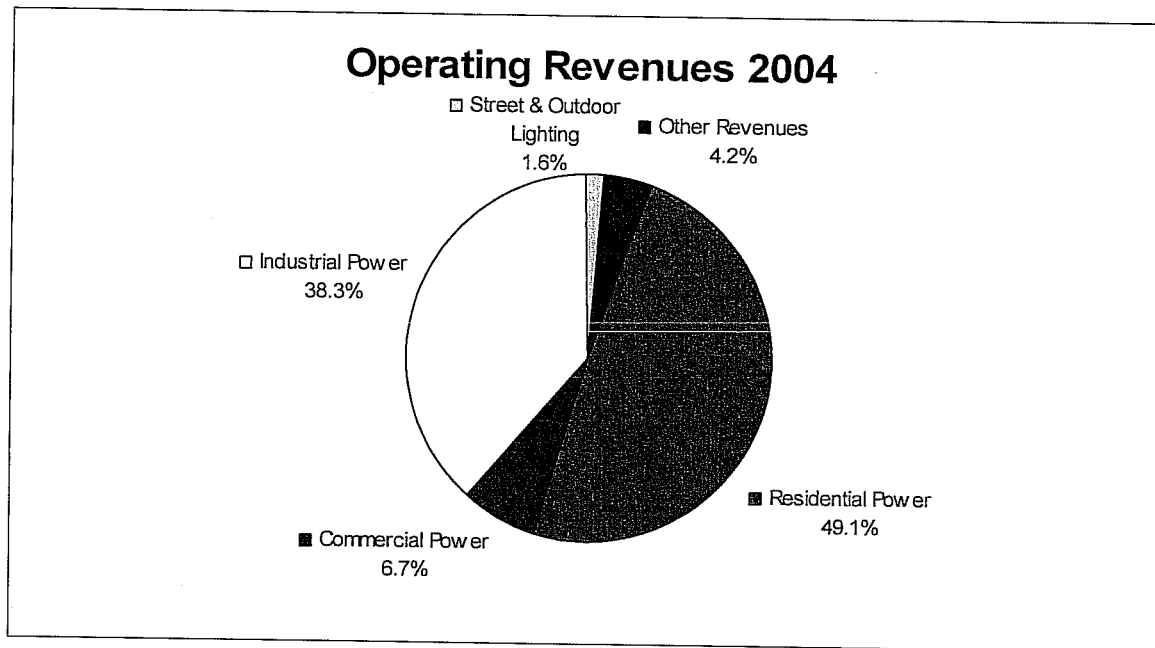
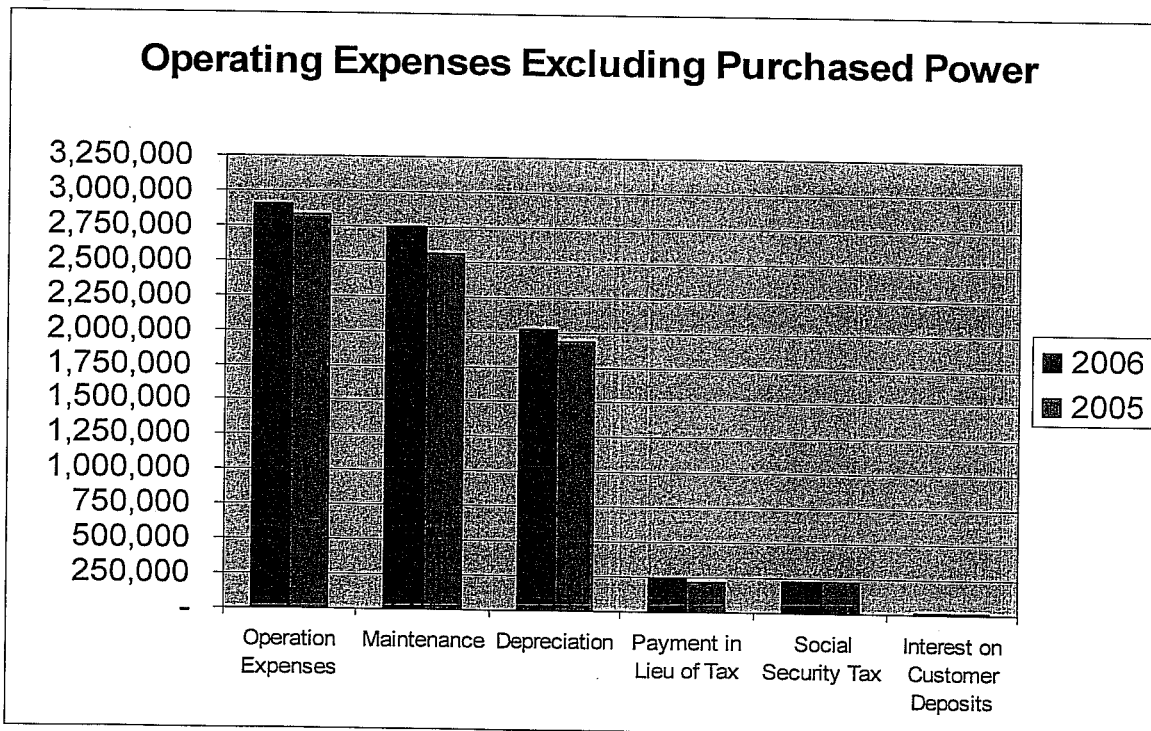


Figure 3



Operating expenses, not including purchased power, increased from 2005 to 2006, as indicated in Figure 4. The total was \$8,158,718 in 2006 compared to \$7,773,377 in 2005, resulting in a 5.0% increase.

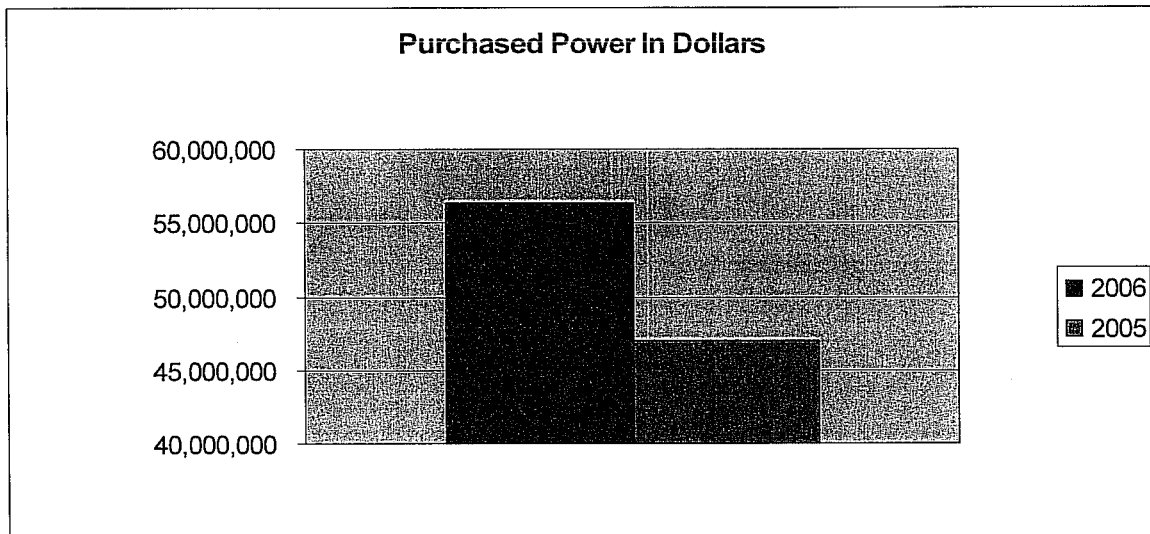
Figure 4



## Management's Discussion and Analysis (continued)

As indicated in Figure 5, purchased power costs were \$56,367,935 in 2006 as compared to \$47,006,165 in 2005, resulting in a 19.9% increase. The correlation between electric sales and purchased power and weather is discussed on page 5. Temperature is typically the main driver; however, recent rate increases passed by TVA has had a large affect on purchased power costs. TVA's rate increase in October 2005, increased purchase power rates by approximately 7.50%. TVA's rate increase in April 2006, increased purchase power rates by approximately 9.95%. No rate changes existed in fiscal year 2005.

**Figure 5**



### Power Rates

BTES purchases its entire year power supply requirements from Tennessee Valley Authority ("TVA"). Rate options available to BTES' retail customers include firm, seasonal and interruptible service rates. The contract between TVA and BTES provides for TVA regulation over retail rates to customers. The interruptible rate programs provide large commercial and industrial customers with the potential for reduced rates along with the right for TVA to interrupt service as needed.

There are four customers participating in interruptible rate programs with a combined interruptible load of 31,017 kilowatts or about 10% of BTES' 2006 peak load. TVA's last curtailment of interruptible customers occurred in January 2004. Rate surveys show that BTES' rates are some of the most competitive in the U.S.

## Management's Discussion and Analysis (continued)

### Deregulation

Over the last few years, Congress has been debating legislation to restructure the electric utility industry. Because of TVA's unique situation, deregulation and competition at both national and state levels are moving more slowly to the Tennessee Valley. Under the existing law, TVA is the exclusive supplier of power within its statutorily defined service territory, an 80,000 square-mile area that includes virtually the entire state of Tennessee and parts of Kentucky, Mississippi, Alabama, Georgia, North Carolina and Virginia. BTES is shielded from competition until federal restructuring addresses the current law. BTES continues to be involved in the restructuring effort individually and also as a member of the Tennessee Valley Public Power Association, the American Public Power Association, Tennessee Municipal Electric Power Association and the State of Tennessee Legislature.

### Debt

On July 27, 2005, BTES issued \$23,910,000 in Electric Revenue Bonds, Series 2005 for the purpose of financing improvements to BTES' system and pre-purchasing electrical power from TVA. The bonds are limited obligations of BTES payable solely from the net power revenues of BTES.

The following is the bond activity for fiscal year 2006:

	Balance			Balance
	July 1, 2005	Additions	Decreases	June 30, 2006
Electric Revenue Bonds	\$-	\$24,361,855	\$(14,576)	\$24,347,279

As the bonds are tax exempt and the bond proceeds are externally restricted for a specific purpose, GAAP requires interest income from the bond proceeds and interest expense on the outstanding bonds be netted for financial statement purposes; however, as all of the proceeds were used for improvements to BTES' transmission and distribution systems, the net interest expense of approximately \$366,000 was capitalized during fiscal year 2006.

Additional information on the bond payable can be found in Note 10 of this report.

## **Management's Discussion and Analysis (continued)**

### **Payment In Lieu of Taxes**

BTES makes in-lieu-of-tax payments to the municipalities and counties in which it sells power and has electric utility plant. For the City of Bristol, Tennessee, City of Bluff City, Tennessee and Sullivan County, Tennessee, the in-lieu-of-tax payment is based on the formula provided by the State of Tennessee Municipal Electric System Tax Equivalent Law of 1987. The formula includes a property tax equivalency calculation plus 4% of operating revenue less power costs (three-year average). For Washington County, Virginia the in-lieu-of-tax payment is based on the real property tax rate of the electric utility plant. The total in lieu of taxes paid during the years ended June 30, 2006 and 2005 were approximately \$1,308,000 and \$573,000, respectively. The differing amounts are attributed to a payment to the City of Bristol, Tennessee in the amount of \$361,146 related to fiscal year 2005.

### **Non-Operating Revenue**

Interest from investments increased from \$892,961 in 2005 to \$997,881 in 2006, resulting in an approximate 12% increase. This is due primarily to higher interest rates in 2006. As shown in Table 4, interest from investments is categorized as non-operating revenue. BTES continues to look for ways to maximize their earnings, such as the TVA's Discounted Energy Units Program discussed below.

### **Discounted Energy Units (DEU) Program**

BTES invested \$8,000,000 in TVA's Discounted Energy Units ("DEU") Program in December 2003. The goal of the DEU Program is to create a financial partnership between TVA and its distributors, such as BTES, to help finance the re-start of the Browns Ferry Unit One power generator. This facility uses nuclear fuel to generate electricity. The potential benefits for BTES are to ensure a reliable, low-cost power supply and provide a vehicle to better use operating cash and improve working capital liquidity. This program provides BTES discounted monthly electric purchases that are equal to the monthly principle and interest payments. The discount rate is 5.5% and has a term of 10 years. BTES may borrow against part of the DEU investment in emergency situations, if needed.

During 2006 and 2005, BTES recognized \$334,468 and \$372,347, respectively; in interest income from the amortization of the DEU's which is included in non-operating revenues discussed above.

### **Commitments**

BTES has commitments for projects outstanding in the amount of approximately \$4,390,000 as of June 30, 2006.

# Bristol Tennessee Essential Services

## Balance Sheets

June 30, 2006 and 2005

	June 30	
	2006	2005
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 12,176,520	\$ 7,393,582
Accounts receivable:		
Trade	3,281,473	3,006,812
Other	502,908	992,774
Total accounts receivable	3,784,381	3,999,586
Accrual for unbilled revenues	3,124,920	2,803,538
Materials and supplies inventories	1,307,996	881,205
Prepaid power purchased from Tennessee Valley Authority	-	3,093,653
Current portion of customer notes receivable	406,000	456,000
Current portion of discounted energy units	749,547	709,532
Prepaid expenses and other current assets	210,020	152,105
Total current assets	21,759,384	19,489,201
Unrestricted noncurrent assets:		
Capital assets:		
Capital assets in service	67,688,084	64,203,920
Less accumulated depreciation	(41,076,189)	(39,157,485)
	26,611,895	25,046,435
Construction in progress	19,117,810	8,004,376
Non-utility property	975,480	974,980
Net capital assets	46,705,185	34,025,791
Other assets:		
Customer notes receivable, less current portion	1,988,023	1,945,953
Long-term investments	8,000,000	8,000,000
Prepaid pension cost	675,111	730,569
Discounted energy units, less current portion	4,945,292	5,694,839
Unamortized bond issue costs	347,505	-
Other	432,638	108,794
Total other assets	16,388,569	16,480,155
Total unrestricted noncurrent assets	63,093,754	50,505,946
Restricted cash and cash equivalents	11,173,161	-
Total noncurrent assets	74,266,915	50,505,946
Total assets	\$ 96,026,299	\$ 69,995,147



Bristol Tennessee Essential Services

Balance Sheets (continued)

June 30, 2006 and 2005

	June 30	
	2006	2005
<b>Liabilities and net assets</b>		
Current liabilities:		
Trade accounts payable	\$ 1,699,192	\$ 2,429,452
Accrual for unbilled power expense	2,781,509	2,382,801
Customer deposits and prepayments	2,088,295	2,029,920
Economic development funds passed through from Tennessee Valley Authority to City of Bristol, Tennessee	197,972	824,042
Other accrued liabilities	1,328,823	841,385
Total current liabilities	8,095,791	8,507,600
Bonds payable	24,347,279	-
Total liabilities	32,443,070	8,507,600
Net assets:		
Invested in capital assets, net of related debt	33,878,572	34,025,791
Unrestricted	29,704,657	27,461,756
Total net assets	63,583,229	61,487,547

Total liabilities and net assets

\$ 96,026,299 \$ 69,995,147

See accompanying Notes to Financial Statements.

# Bristol Tennessee Essential Services

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

Years ended June 30, 2006 and 2005

	Year ended June 30	
	2006	2005
Operating revenues:		
Power revenues:		
Residential	\$ 30,666,486	\$ 27,474,740
Commercial (general power - under 50 kw)	4,363,430	3,935,881
Industrial (general power - 50 kw and over)	27,844,587	22,523,896
Street and outdoor lighting	983,468	964,844
Total power revenues	63,857,971	54,899,361
Cable revenues	247,943	-
Internet revenues	105,498	-
Other revenues	2,517,842	2,424,368
Total operating revenues	66,729,254	57,323,729
Power purchased from Tennessee Valley Authority	56,367,935	47,006,165
Gross profit	10,361,319	10,317,564
Operating expenses:		
Operations	2,901,136	2,829,462
Maintenance	2,750,187	2,559,977
Depreciation	2,024,190	1,937,812
Tax equivalents	238,009	214,494
Social security taxes	228,588	224,130
Interest expense on customer deposits	16,608	7,502
Total operating expenses	8,158,718	7,773,377
Operating income	2,202,601	2,544,187
Nonoperating revenue (expense):		
Interest income (including \$334,468 in 2006 and \$372,347 in 2005 related to amortization of discounted energy units)	997,881	892,961
Amortization of bond issue costs	(11,582)	-
Income before transfers	3,188,900	3,437,148
Transfers out--tax equivalents to the City of Bristol, Tennessee	(1,093,218)	(361,146)
Change in net assets	2,095,682	3,076,002
Net assets at beginning of year	61,487,547	58,411,545
Net assets at end of year	\$ 63,583,229	\$ 61,487,547

See accompanying Notes to Financial Statements.

# Bristol Tennessee Essential Services

## Statements of Cash Flows

Years ended June 30, 2006 and 2005

	Year ended June 30	
	2006	2005
<b>Cash flows from operating activities</b>		
Cash received from customers	\$ 65,205,681	\$ 56,052,112
Cash received from City of Bristol, Tennessee	1,643,776	1,360,803
Cash paid to suppliers and vendors	(54,817,582)	(50,444,478)
Cash paid to employees for services	(3,178,298)	(3,017,231)
Cash paid to City of Bristol, Tennessee	(668,752)	(10,685)
Net cash provided by operating activities	8,184,825	3,940,521
<b>Cash flows from noncapital financing activities</b>		
Transfers to City of Bristol, Tennessee	(1,093,218)	(361,146)
<b>Cash flows from investing activities</b>		
Interest received on investments	1,376,507	520,614
<b>Cash flows from capital and related financing activities</b>		
Net proceeds from bonds payable	23,992,767	-
Interest payments on bonds payable	(705,114)	-
Net additions to capital assets	(15,799,668)	(2,884,317)
Net cash provided by (used in) capital and related	7,487,985	(2,884,317)
Increase in cash and cash equivalents	15,956,099	1,215,672
Cash and cash equivalents at beginning of year	7,393,582	6,177,910
Cash and cash equivalents at end of year	<u>\$ 23,349,681</u>	<u>\$ 7,393,582</u>

Bristol Tennessee Essential Services  
Statements of Cash Flows (continued)  
Years ended June 30, 2006 and 2005

	Year ended June 30	
	2006	2005
<b>Reconciliation of operating income to net cash provided by operating activities</b>		
Operating income	\$ 2,202,601	\$ 2,544,187
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	2,024,190	1,937,812
Provision for losses on accounts receivable	160,075	248,505
Redemption of discounted energy units	1,044,000	1,044,000
Changes in operating assets and liabilities:		
Accounts receivable	375,280	(489,728)
Accrual for unbilled revenues	(321,382)	114,883
Prepaid power purchased from Tennessee Valley Authority	3,093,653	(2,150,813)
Materials and supplies inventories	(426,791)	(280,158)
Customer notes receivable	7,930	377,183
Prepaid pension cost	55,458	60,582
Other assets	(381,759)	(64,202)
Trade accounts payable	33,119	718,786
Due to City of Bristol, Tennessee	(626,070)	(43,615)
Unbilled power expense	398,708	(127,283)
Customer deposits and prepayments	58,375	86,848
Other accrued liabilities	487,438	(36,466)
Net cash provided by operating activities	<u>\$ 8,184,825</u>	<u>\$ 3,940,521</u>

**Supplemental disclosure of noncash activities**

Accounts payable at June 30, 2006 and 2005 included \$420,686 and \$1,184,065 in construction in progress.

*See accompanying Notes to Financial Statements.*

# Bristol Tennessee Essential Services

## Notes to Financial Statements

June 30, 2006 and 2005

### 1. Significant Accounting Policies

#### General

Bristol Tennessee Essential Services ("BTES") is a self-supporting enterprise fund of the City of Bristol, Tennessee (the "City"). The City is the primary reporting entity. An enterprise fund is used to account for the financing of services to the general public on a continuing basis with costs recovered primarily through user charges. The Board of Directors of BTES is the level of responsibility that has oversight and control of BTES. The Board of Directors sets all policies, local rates and appoints the Chief Executive Officer. The Board of Directors is composed of five members, one of whom is also a member of the City Council, who are appointed by the mayor and confirmed by the City Council. They serve four-year staggered terms. BTES manages, operates and maintains the electric, cable, internet, and telephone utilities servicing the citizens of the City and surrounding areas. BTES issues a comprehensive annual financial report which is combined in the City's comprehensive annual financial report.

BTES has three business units within the enterprise fund, BTES accounts for the electric utility operations in the Electric Business Unit ("EBU"), the cable and internet operations in the Cable and Internet Business Unit ("CBU"), and telephone operations in the Telephone Business Unit ("TBU").

As required by Section 7-52-603 of the Tennessee Code Annotated ("TCA"), the EBU may not subsidize the operations of the CBU or the TBU with revenue from its power operations. In addition, the CBU and the TBU must maintain its own accounting records and any funds that are lent from the EBU must have a rate of interest, not less than the highest rate earned by the EBU on investment funds. See Note 17 for further discussion of these units.

BTES received approval in 2006 from the Tennessee Regulatory Authority for authorization to provide telecommunication services pursuant to Section 7-52-401 of the TCA. The TBU currently has not commenced operations.

The industries that CBU and TBU are entering into are regulated by the Federal Communications Commission.

BTES utilizes the accrual basis of accounting whereby revenues are recorded in the period the related services are provided, and expenses are recorded in the period incurred. Accordingly, BTES has recorded an estimate of unbilled revenue and unbilled power expense. BTES considers all revenues and expenses to be operating, except for interest income and amortization of bond issue costs which are classified as nonoperating.

Bristol Tennessee Essential Services  
Notes to Financial Statements (continued)  
June 30, 2006 and 2005

**1. Significant Accounting Policies (continued)**

**General (continued)**

BTES applies Financial Accounting Standards Board ("FASB") pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict Governmental Accounting Standards Board ("GASB") pronouncements, in which case, GASB prevails. BTES has elected not to adopt the FASB Statements and Interpretations issued after November 30, 1989, in accordance with GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting."

BTES applies the provisions GASB No. 34, "Basic Financial Statements--and Management's Discussion and Analysis--for State and Local Governments" ("Statement 34"), as amended by GASB No. 37, "Basic Financial Statements--and Management's Discussion and Analysis--for State and Local Government: Omnibus" ("Statement 37"). Statements 34 and 37 established standards for external financial reporting and disclosure for all state and local governmental entities, which includes a balance sheet, a statement of revenues, expenses and changes in net assets and a statement of cash flows. Statement 34 requires the classification of net assets into three components – invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- Invested in capital assets, net of related debt – This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.
- Restricted – This component of net assets consists of constraints placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
- Unrestricted – This component of net assets consists of net assets that do not meet the definition of "restricted or "invested in capital assets, net of related debt."

The unrestricted category includes a renewal and replacement fund of \$8,000,000 which was established by the Board of Directors to set aside funds for future construction, improvements and extensions of BTES.

Bristol Tennessee Essential Services  
Notes to Financial Statements (continued)  
June 30, 2006 and 2005

**1. Significant Accounting Policies (continued)**

**Measurement Focus**

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. BTES operations are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of the enterprise fund are included on the balance sheet. Operating statements present increases (e.g. revenues) and decreases (e.g. expenses) in net total assets.

**Fiscal Year-End**

BTES operates on a fiscal year ending June 30. All references in these notes refer to the fiscal year-end unless otherwise specified.

**Materials and Supplies Inventories**

Materials and supplies are valued at the lower of cost or market, utilizing the moving average method of determining cost.

**Capital Assets**

Capital assets are carried at historical cost, including applicable general and administrative costs and payroll related costs such as pensions, taxes and other employee benefits. Substantially all renewals and betterments are capitalized in accordance with BTES' capitalization policy. When property is retired or otherwise disposed of, its average cost, together with its cost of removal less salvage, is charged to accumulated depreciation; no gain or loss is recognized.

Capital assets other than land, construction in progress and non-utility property, are depreciated using the straight-line method at rates which will amortize costs over the estimated useful lives of the assets. The estimated useful lives of depreciable capital assets are as follows:

Transmission equipment, fixtures and devices	30 to 40 years
Distribution transformers, meters, fixtures and devices	15 to 50 years
Buildings and improvements	50 years
Electronic communication equipment	15 to 20 years
Furniture, fixtures and equipment	5 to 25 years

The provision for depreciation does not include depreciation on transportation equipment. Those amounts are reported as operating expenses in the Statements of Revenues, Expenses and Changes in Net Assets and totaled \$88,807 in 2006 and \$98,070 in 2005. The cost of maintenance and repairs is charged to expense as incurred.

**Investments**

Temporary investments, consisting entirely of certificates of deposit, are stated at cost which approximates fair value.

Bristol Tennessee Essential Services  
Notes to Financial Statements (continued)  
June 30, 2006 and 2005

**1. Significant Accounting Policies (continued)**

**Compensated Absences**

BTES recognizes the cost of vacation pay as earned. In the event of termination or retirement, an employee is reimbursed for accumulated vacation days. In general, accumulated vacation days are limited to thirty days.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**Cash and Cash Equivalents and Investments**

Cash and cash equivalents include cash on hand and in demand deposits, and those investments which are generally a part of BTES short-term cash management activities. State statutes authorize BTES to invest in certificates of deposit, U.S. Treasury obligations, U.S. Agency issues and the State Local Government Investment Pool.

**2. Power Contract**

BTES has a power contract with the Tennessee Valley Authority ("TVA") whereby BTES purchases all its electric power from TVA and is subject to certain restrictions and conditions as provided in the contract. Either party may terminate this contract at any time upon not less than five years prior written notice.

**3. Residential Energy Efficiency Program Loans**

BTES provides loans to customers for heat pump and insulation costs under BTES Residential Energy Efficiency Program. The majority of these loans bears interest at rates ranging from 8% to 10.25% and has maturities of up to 10 years. Satisfactory credit reports are required prior to loan approval. Additionally, these loans are secured by a deed of trust on the property. BTES recorded interest income of approximately \$240,000 in 2006 and \$257,000 in 2005 related to these loans. These amounts offset operating expenses in the Statements of Revenues, Expenses and Changes in Net Assets, since management believes this is an operating activity and the income should offset the additional expenses associated with maintaining this loan program.



Bristol Tennessee Essential Services  
Notes to Financial Statements (continued)

June 30, 2006 and 2005

**4. Concentration of Credit Risk**

BTES provides electric service primarily to customers in northeastern Tennessee. Customers include residential and industrial service. Residential customers are required to have satisfactory credit reports or place deposits with BTES that approximate two months' highest expected bill. Industrial customers are generally required to either place deposits with BTES that approximate two months' highest expected bill or obtain a letter of credit or surety bond as security. Interest accrues on any deposits at the passbook interest rate of the bank where the funds are deposited and totaled \$16,608 in 2006 and \$7,502 in 2005. BTES also makes and services loans to customers for heat pump and insulation costs. A subordinate deed of trust is obtained on the related property for these loans. Loss experience on accounts and notes receivable has not been significant to BTES operations.

**5. Pension Plan**

**Plan Description**

Certain employees of BTES are members of the Political Subdivision Pension Plan ("PSPP"), an agent multiple-employer defined benefit pension plan administered by the Tennessee Consolidated Retirement System ("TCRS"). TCRS provides retirement benefits as well as death and disability benefits. Benefits are determined by a formula using the member's high five-year average salary and years of service. Members become eligible to retire at the age of 60 with five years of service or at any age with 30 years of service. A reduced retirement benefit is available to vested members at the age of 55. Disability benefits are available to active members with five years of service who became disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member was in the performance of duty. Members joining BTES after July 1, 1979, become vested after five years of service and members joining prior to July 1, 1979, were vested after four years of service. Benefit provisions are established in state statute found in Title 8, Chapter 34-37 of the *Tennessee Code Annotated* ("TCA"). State statutes are amended by the Tennessee General Assembly. Political subdivisions such as BTES participate in the TCRS as individual entities and are liable for all costs associated with the operation and administration of their plan. Benefit improvements are not applicable to a political subdivision unless approved by the chief governing body.

The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for the PSPP. That report may be obtained by writing to Tennessee Treasury Department, Consolidated Retirement System, 10th Floor Andrew Jackson Building, Nashville, Tennessee 37243-0230 or can be accessed at [www.treasury.state.tn.us](http://www.treasury.state.tn.us). Copies of footnotes in PDF format can be accessed at [www.treasury.state.tn.us/tcrs/ps/](http://www.treasury.state.tn.us/tcrs/ps/).

**Funding Policy**

BTES requires employees to contribute 5% of earnable compensation.

Bristol Tennessee Essential Services  
Notes to Financial Statements (continued)  
June 30, 2006 and 2005

**5. Pension Plan (continued)**

**Funding Policy (continued)**

BTES is required to contribute at an actuarially determined rate using the frozen entry age actuarial cost method; the rate for 2006 and 2005 was 11.23% of annual covered payroll. The 2006 and 2005 required contributions were determined as part of the July 1, 2003 actuarial valuation. An actuarial valuation was performed as of July 1, 2005, which established contribution rates effective July 1, 2006. The contribution requirements for plan members are set by state statute. The contribution requirements for BTES are established and may be amended by the TCRS Board of Trustees.

**Prepaid Pension Cost**

GASB Statement No. 27, "Accounting for Pensions by State and Local Governmental Employers", requires employers to record contributions to a pension plan in excess of the annual pension cost as an asset. BTES has previously contributed amounts in excess of the annual pension cost to the PSPP and recorded these amounts as a prepaid pension cost. Activity in the prepaid pension cost is as follows for the years ended June 30:

	2006	2005
Balance at beginning of year	\$730,569	\$791,151
Annual pension cost:		
Annual required contribution	338,163	332,686
Interest on prepaid pension cost	(55,142)	(59,336)
Adjustment to the annual required contribution	110,600	119,918
Total annual pension cost	393,621	393,268
Contributions made	338,163	332,686
Decrease in prepaid pension cost	(55,458)	(60,582)
Balance at end of year	\$675,111	\$730,569

**Actuarial Assumptions**

Significant actuarial assumptions used in the July 1, 2003, valuation include (a) rate of return on investment of present and future assets of 7.5% a year compounded annually, (b) projected salary increases of 4.75% (graded) annual rate (no explicit assumption is made regarding the portion attributable to the effects of inflation on salaries), (c) projected 3.5% annual increase in the Social Security wage base and (d) projected post-retirement increases of 3% annually. The actuarial value of assets was determined using techniques that smooth the effect of short-term volatility in the fair value of total investments over a five-year period. BTES' unfunded actuarial accrued liability is being amortized as a level dollar amount on a closed basis. The remaining amortization period at July 1, 2005, was 10 years.

Bristol Tennessee Essential Services  
Notes to Financial Statements (continued)  
June 30, 2006 and 2005

**5. Pension Plan (continued)**

**Trend Information**

<u>Year ended June 30</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Prepaid Pension Cost</u>
2006	\$393,621	85.9%	\$675,111
2005	393,268	84.6%	730,569
2004	290,649	51.2%	791,151

**Required Supplementary Information**

Schedule of Funding Progress (Dollar amounts in thousands)

<u>Actuarial Valuation Date</u>	<u>Actuarial Value of Assets</u>	<u>Actuarial Accrued Liability (AAL)</u>	<u>Unfunded AAL (UAAL)</u>	<u>Funded Ratio</u>	<u>Covered Payroll</u>	<u>UAAL as a Percentage of Covered Payroll</u>
7/01/05	\$12,335	\$13,290	\$ 955	92.81%	\$2,890	33.04%
7/01/03	11,831	12,907	1,076	91.66%	2,584	41.64%
7/01/01	11,492	12,584	1,092	91.32%	2,465	44.30%

**6. 401(k) Retirement Plan**

BTES administers a defined contribution plan in the form of a 401(k) plan (Bristol Tennessee Electric System 401(k) Retirement Plan) available to all employees who have completed six months of employment. During 2006, the amount of payroll covered by the plan was \$2,628,323 of total payroll of \$3,101,298. During 2005, the amount of payroll covered by the plan was \$2,643,012 of total payroll of \$2,941,973. Under the plan terms, BTES will match participant contributions up to 6% of the participant's salary. Participants are not required but may contribute up to a total of 15% of their pre-tax earnings, subject to IRS limitations.

Additionally, participants may contribute up to 10% of their after-tax earnings. Participants are 100% vested in the employer contributions when they are made. During 2006 and 2005, BTES contributed \$155,009 and \$150,528, respectively, to the plan which represents 5.9% and 5.7%, respectively, of the covered payroll and 100% of the required contribution for each year. During 2006 and 2005, the participants contributed \$218,023 and \$204,321, respectively, which represents 8.3% and 7.7%, respectively, of the covered payroll.

Bristol Tennessee Essential Services  
Notes to Financial Statements (continued)  
June 30, 2006 and 2005

**7. Capital Assets**

The following is a summary of capital assets for the year ended June 30, 2006:

	Balance July 1, 2005	Increases	Decreases	Balance June 30, 2006
Capital assets not being depreciated:				
Land	\$ 1,051,638	\$ —	\$ —	\$ 1,051,638
Non-utility property	974,980	500	—	975,480
Construction in progress	8,004,376	14,144,357	(3,030,923)	19,117,810
Total capital assets not being depreciated	10,030,994	14,144,857	(3,030,923)	21,144,928
Capital assets being depreciated:				
Transmission equipment, fixtures and devices	2,822,620	—	—	2,822,620
Distribution transformers, meters, fixtures and devices	55,076,254	459,865	(49,502)	55,486,617
Buildings and improvements	2,016,234	5,451	—	2,021,685
Furniture, fixtures and equipment	3,237,174	3,068,350	—	6,305,524
Total capital assets being depreciated	63,152,282	3,533,666	(49,502)	66,636,446
Less accumulated depreciation:				
Transmission equipment, fixtures and devices				
Distribution transformers, meters, fixtures and devices	(1,262,059)	(112,818)	—	(1,374,877)
Buildings and improvements	(33,803,054)	(1,768,914)	194,293	(35,377,675)
Furniture, fixtures and equipment	(1,826,756)	(35,903)	—	(1,862,659)
Total accumulated depreciation	(2,265,616)	(195,362)	—	(2,460,978)
Net capital assets being depreciated	(39,157,485)	(2,112,997)	194,293	(41,076,189)
Net capital assets being depreciated	23,994,797	1,420,669	144,791	25,560,257
Total net capital assets	\$34,025,791	\$15,565,526	\$(2,886,132)	\$46,705,185

During 2006, BTES capitalized approximately \$366,000 in interest expense, which was netted against \$14,576 in bond premium amortization.

Bristol Tennessee Essential Services  
Notes to Financial Statements (continued)

June 30, 2006 and 2005

**8. Cash and Investments**

Cash and investments consist of the following as of June 30, 2006:

	Amount	Interest Rate	Purchase Date	Maturity Date
Renewal and replacement fund:				
Certificate of deposit	\$ 1,500,000	4.74%	1/31/06	7/29/06
Certificate of deposit	2,000,000	4.98%	4/11/06	7/11/06
Certificate of deposit	2,000,000	4.65%	5/02/06	8/02/06
Certificate of deposit	2,500,000	4.75%	6/08/06	9/08/06
Total renewal and replacement fund	<u>8,000,000</u>			
Other funds:				
Certificate of deposit	520,432	4.15%	6/11/06	7/11/06
Certificate of deposit	2,123,811	4.65%	5/02/06	8/02/06
Certificate of deposit	2,325,712	5.16%	6/01/06	9/01/06
Certificate of deposit	2,501,126	4.74%	1/31/06	7/31/06
Business money market account	2,522,226	4.89%	—	—
Business money market account	11,173,161	4.87%	—	—
Cash on deposit	2,183,213	Various	—	—
Total other funds	<u>23,349,681</u>			
Total cash and investments	<u>\$31,349,681</u>			

Cash and investments consist of the following as of June 30, 2005:

	Amount	Interest Rate	Purchase Date	Maturity Date
Renewal and replacement fund:				
Certificate of deposit	\$ 2,000,000	2.90%	4/01/05	7/01/05
Certificate of deposit	2,000,000	3.00%	4/16/05	7/16/05
Certificate of deposit	2,000,000	3.10%	5/30/05	7/31/05
Certificate of deposit	2,000,000	3.10%	5/30/05	7/31/05
Total renewal and replacement fund	<u>8,000,000</u>			
Other funds:				
Certificate of deposit	3,114,639	2.90%	5/30/05	6/30/05
Certificate of deposit	500,000	3.06%	6/09/05	7/09/05
Business money market account	2,356,853	2.84%	—	—
Cash on deposit	1,422,090	Various	—	—
Total other funds	<u>7,393,582</u>			
Total cash and investments	<u>\$15,393,582</u>			

Bristol Tennessee Essential Services  
Notes to Financial Statements (continued)  
June 30, 2006 and 2005

**8. Cash and Investments (continued)**

As of June 30, 2006, BTES deposits in financial institutions (including certificates of deposit) of \$33,025,398 were entirely insured or collateralized with securities held by BTES agent in BTES' name. Carrying amounts differ from financial institution balances primarily due to outstanding checks and deposits in transit.

Purchases of certificates of deposit in the renewal and replacement fund totaled \$37,827,000 in 2006 and \$20,524,000 in 2005. Sales of certificates of deposit in the renewal and replacement fund totaled \$37,827,000 in 2006 and \$20,524,000 in 2005.

**9. Discounted Energy Units**

During 2003, BTES purchased \$8,000,000 in discounted energy units from TVA which are redeemable on a straight-line basis over the next ten years. The units carry a discount of 5.5% and amounted to \$5,694,839 and \$6,404,371 as of June 30, 2006 and 2005, respectively.

**10. Bonds Payable**

The following is a summary of the bonds payable for the year ended June 30, 2006:

	Balance July 1, 2005	Additions	Decreases	Balance June 30, 2006
Electric System Revenue Bonds, Series 2005	\$ -	\$23,910,000	\$ -	\$23,910,000
Plus unamortized premium	-	451,855	(14,576)	437,279
Total bonds payable	\$ -	\$24,361,855	\$(14,576)	\$24,347,279

During 2006, the City issued \$23,910,000 in 2005 Electric System Revenue Bonds (the "Bonds") on behalf of BTES. The Bonds were issued for the purposes of providing funds to construct improvements and extensions of BTES' transmission and distribution system and to pre-purchase electric power from TVA. The Bonds are payable in annual installments ranging from \$440,000 in 2008 to \$1,450,000 in 2036. Bonds maturing on or after September 1, 2016 (\$18,765,000) are callable by the City at par at any time in any amount on or after September 1, 2015.

The interest rates on the Bonds are fixed and for each series, however, the interest rates for each series vary between 3.25% to 5% depending on the maturity. For 2006, the effective annual interest rate on the Bonds was 4.413%.

The Bonds are secured by the net power revenues of BTES. As of June 30, 2006, BTES had \$11,173,161 in cash and cash equivalents from the proceeds of the debt issuance which are restricted for the purposes indicated above. In addition, BTES has obtained a surety bond in lieu of funding a debt service reserve fund as required by the bond agreement.

Bristol Tennessee Essential Services  
Notes to Financial Statements (continued)

June 30, 2006 and 2005

**10. Bonds Payable (continued)**

Maturities of the Bonds as of June 30, 2006, are as follows:

Fiscal Year	Principal	Interest	Total
2007	\$ —	\$ 1,055,100	\$ 1,055,100
2008	440,000	1,047,400	1,487,400
2009	455,000	1,031,738	1,486,738
2010	470,000	1,015,550	1,485,550
2011	485,000	998,838	1,483,838
2012-2016	2,695,000	4,731,028	7,426,028
2017-2021	3,295,000	4,137,845	7,432,845
2022-2026	4,195,000	3,237,488	7,432,488
2027-2031	5,265,000	2,169,665	7,434,665
2032-2036	6,610,000	820,626	7,430,626
	<u>\$23,910,000</u>	<u>\$20,245,278</u>	<u>\$44,155,278</u>

**11. Self-Insurance Plan**

BTES is self-insured for employee group health benefits. A liability is recorded, if necessary, for those claims incurred but not paid prior to year-end, both reported and unreported, based on prior experience and claims reported subsequent to year-end. Changes in estimates for claims incurred but not reported are recorded in the year the estimates are revised. BTES' risk is \$50,000 per covered employee up to an annual maximum of \$424,204. An insurance company has insured all claims exceeding \$424,204.

Activity in the estimated liability for claims incurred but not paid is as follows for the years ended June 30:

	2006	2005
Balance at beginning of year	\$ —	\$ —
Expense recorded related to:		
Current year	281,370	200,209
Prior year	27,000	86,488
Net expense recorded	<u>308,370</u>	<u>286,697</u>
Payments related to:		
Current year	281,242	200,081
Prior year	27,128	86,616
Total payments	<u>308,370</u>	<u>286,697</u>
Balance at end of year	<u>\$ —</u>	<u>\$ —</u>

Bristol Tennessee Essential Services  
Notes to Financial Statements (continued)

June 30, 2006 and 2005

**12. Risk Management**

BTES is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; natural disasters; and injuries of employees for which BTES carries commercial insurance purchased from independent third parties. BTES has not experienced a settlement in excess of insurance coverage in any of the past three fiscal years. BTES bears the risk of loss up to the deductible amounts which are disclosed in the accompanying Statistical Section.

**13. Related Party Transactions**

As described in Note 1, BTES is a self-supporting fund of the City. In the normal course of operations, BTES provides electrical service to the City at standard electric rates which generated revenues of \$1,662,054 in 2006 and \$1,356,140 in 2005. As of June 30, 2006 and 2005, \$121,949 and \$103,671, respectively, was recorded as a receivable from the City for these revenues. Payment is due within approximately 30 days of the billing.

During 1997, BTES received \$2,000,000 in purchased power credits from TVA for investments related to economic development of the City. At the City's request, BTES remits these funds to the City. Remaining activity related to these funds is as follows for the years ended June 30:

	2006	2005
Balance at beginning of year	\$824,042	\$811,039
Interest accruals	21,020	13,003
Payments remitted to City	(647,090)	—
Balance at end of year	<u>\$197,972</u>	<u>\$824,042</u>

Interest accruals are netted against interest income in the accompanying financial statements.

BTES made tax equivalent payments to the City of \$1,093,218 in 2006 and \$361,146 in 2005. These payments are based on BTES capital assets, along with average operating revenues less power costs.

**14. Postemployment Benefits**

As discussed in Note 11, BTES is self-insured for employee group health benefits. BTES also provides these benefits to certain retired employees, although not required by any statutory, contractual or other authority. As of June 30, 2006, there were 21 retirees eligible to receive these benefits. Benefits related to these retirees are expensed when paid and totaled approximately \$77,000 in 2006 and \$75,000 in 2005.



Bristol Tennessee Essential Services  
Notes to Financial Statements (continued)  
June 30, 2006 and 2005

**14. Postemployment Benefits (continued)**

Additionally, BTES is self-insured for certain life insurance benefits for retirees. Employees who retire with 30 years of service or age 60 with a minimum of 20 years of service receive \$5,000 in life insurance for annual salaries less than \$10,000 plus \$1,000 in life insurance for each additional \$5,000 of annual salary or fraction thereof. As of June 30, 2006, there were 11 retirees eligible to receive these benefits and, accordingly, a liability for \$117,250 has been recorded for these benefits. BTES made no payments in 2006 and 2005 related to these benefits.

**15. Net Assets**

Net assets consist of the following as of June 30:

	2006	2005
Invested in capital assets, net of related debt consists of the following:		
Capital assets	\$46,705,185	\$34,025,791
Other assets--bond issue costs	347,505	-
Restricted unspent bond funds	11,173,161	-
Less bond payable	24,347,279	-
Invested in capital assets, net of related debt	<u>\$33,878,572</u>	<u>\$34,025,791</u>

Unrestricted net assets consist of all other items in the balance sheet not reflected above.

**16. Commitments**

As of June 30, 2006, BTES has commitments to purchase approximately \$4,390,000 of equipment related to construction in progress.

**17. Segment Information**

As discussed in Note 1, BTES operates three different business units. BTES allocates direct costs to the specific business unit, common costs (costs that cannot be directly assigned to a business unit) are allocated based on a direct analysis of the origin of the costs, an indirect, cost-causative linkage to another category for which direct assignment or allocation is available, or based on a general allocator. For inter-unit loans, the business unit charges the highest rate of interest earned on invested funds. Depreciation, pole attachment fees, interest expense, and taxes are allocated based on a per service usage model.

Bristol Tennessee Essential Services  
Notes to Financial Statements (continued)

June 30, 2006 and 2005

**17. Segment Information (continued)**

Summary financial statement information for each of the business units are as follows (does not include inter-unit eliminations):

*Condensed Statement of Net Assets by Business Unit*

	June 30, 2006		
	EBU	CBU	TBU
Assets:			
Current assets	\$ 21,684,735	\$ 74,649	\$ -
Due from other business units	4,088,719	-	-
Net capital assets	43,284,440	3,096,846	323,899
Other noncurrent assets	26,890,045	366,576	305,109
Total assets	<u>\$ 95,947,939</u>	<u>\$ 3,538,071</u>	<u>\$ 629,008</u>
Liabilities and net assets:			
Current liabilities	\$ 8,083,087	\$ 12,704	\$ -
Due to other business units	-	3,459,711	629,008
Bonds payable	24,347,279	-	-
Total liabilities	<u>32,430,366</u>	<u>3,472,415</u>	<u>629,008</u>
Invested in capital assets, net of related debt	33,947,111	(68,539)	-
Unrestricted	29,570,462	134,195	-
Total net assets	<u>63,517,573</u>	<u>65,656</u>	<u>-</u>
Total liabilities and net assets	<u>\$ 95,947,939</u>	<u>\$ 3,538,071</u>	<u>\$ 629,008</u>

Bristol Tennessee Essential Services  
Notes to Financial Statements (continued)

June 30, 2006 and 2005

17. Segment Information (continued)

*Condensed Statement of Revenues, Expenses and Changes in Net Assets*

	Year ended June 30, 2006		
	EBU	CBU	TBU
Operating revenues	\$ 66,375,813	\$ 353,441	\$ -
Power purchased	56,367,935	-	-
Gross profit	10,007,878	353,441	-
Operating expenses	7,870,933	287,785	-
Operating income	2,136,945	65,656	-
Nonoperating revenue	986,299	-	-
Income before transfers	3,123,244	65,656	-
Transfers out	(1,093,218)	-	-
Change in net assets	2,030,026	65,656	-
Net assets at beginning of year	61,487,547	-	-
Net assets at end of year	\$ 63,517,573	\$ 65,656	\$ -

*Condensed Statement of Cash Flows by Business Unit*

	Year ended June 30, 2006		
	EBU	CBU	TBU
Net cash provided (used in) by:			
Operating activities	\$ 8,184,825	\$ -	\$ -
Noncapital financing activities	(1,093,218)	-	-
Investing activities	1,376,507	-	-
Capital and related financing activities	7,487,985	-	-
Increase in cash and cash equivalents	15,956,099	-	-
Cash and cash equivalents at beginning	7,393,582	-	-
Cash and cash equivalents at end of year	\$ 23,349,681	\$ -	\$ -

# Bristol Tennessee Essential Services

## Schedule of Net Assets (Last Ten Years)

### Fiscal Years 2006 - 1997 (in thousands)

	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
Invested in capital assets, net of related debt	\$ 33,879	\$ 34,026	\$ 31,895	\$ 31,568	\$ 29,297	\$ 27,744	\$ 27,753	\$ 28,273	\$ 27,902	\$ 27,168
Unrestricted	29,705	27,462	26,516	24,485	26,346	26,658	24,408	21,255	19,831	18,955
Total net assets	<u>\$ 63,584</u>	<u>\$ 61,488</u>	<u>\$ 58,411</u>	<u>\$ 56,053</u>	<u>\$ 55,643</u>	<u>\$ 54,402</u>	<u>\$ 52,161</u>	<u>\$ 49,528</u>	<u>\$ 47,733</u>	<u>\$ 46,123</u>

Note 1: Information is summarized from audited financial statements for the year indicated.

Bristol Tennessee Essential Services  
Statement of Revenues and Expenses (Last Ten Years)

Fiscal Years 2006-1997 (in thousands)

	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
Operating revenues:										
Residential	\$ 30,666	\$ 27,475	\$ 28,368	\$ 26,699	\$ 24,746	\$ 25,877	\$ 24,212	\$ 23,575	\$ 23,408	\$ 21,993
Commercial	4,363	3,936	3,888	3,621	3,373	3,562	3,442	3,408	3,280	3,065
Industrial	27,845	22,524	22,143	20,072	19,006	19,650	18,953	19,224	17,814	16,619
Street and outdoor lighting	984	965	911	855	852	919	844	832	815	775
Cable and internet	353	-	-	-	-	-	-	-	-	-
Other revenues	2,518	2,424	2,448	2,100	2,018	2,023	1,919	1,844	1,807	1,648
Total operating revenues	66,729	57,324	57,758	53,347	49,995	52,031	49,370	48,883	47,124	44,100
Power purchased from Tennessee Valley Authority	56,368	47,006	48,328	44,701	41,631	43,630	41,265	40,913	39,373	36,470
Gross profit	10,361	10,318	9,430	8,646	8,364	8,401	8,105	7,970	7,751	7,630
Operating expenses:										
Operation expenses	2,901	2,829	2,743	2,599	2,412	2,339	2,213	2,128	1,975	1,955
Maintenance	2,750	2,560	2,635	2,533	2,319	2,275	2,212	2,137	2,267	2,060
Depreciation	2,024	1,938	1,898	1,960	1,918	1,863	1,814	1,765	1,655	1,390
Tax equivalents	238	214	212	206	195	857	868	913	888	858
Social security taxes	228	224	206	213	193	162	158	156	156	161
Interest on customer deposits	17	8	6	6	11	19	19	17	17	17
Total operating expenses	8,158	7,773	7,700	7,517	7,048	7,515	7,284	7,116	6,958	6,441
Operating income	2,203	2,545	1,730	1,129	1,316	886	821	854	793	1,189
Net nonoperating revenue	986	892	628	587	591	1,355	1,071	918	816	875
Income before transfers	3,189	3,437	2,358	1,716	1,907	2,241	1,892	1,772	1,609	2,064
Transfers out--tax equivalents to the City of Bristol, Tennessee	(1,093)	(361)	(700)	(606)	(666)	-	-	-	-	-
Change in net assets	\$ 2,096	\$ 3,076	\$ 1,658	\$ 1,110	\$ 1,241	\$ 2,241	\$ 1,892	\$ 1,772	\$ 1,609	\$ 2,064

Note 1: Cable and internet services commenced in 2006.

# Bristol Tennessee Essential Services

## Purchased Power, Consumption and Active Service Statistics (Last Ten Years)

Fiscal Years 2006-1997

	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
Purchased power from Tennessee Valley Authority (megawatt hours)	1,039,435	1,003,918	1,014,411	997,525	935,485	961,853	918,151	919,696	913,322	882,682
Consumption (megawatt hours):										
Residential	472,002	454,880	468,611	469,302	432,282	456,277	425,639	416,726	419,346	403,494
Commercial	55,620	53,642	53,344	54,335	49,880	52,200	51,351	51,337	50,391	49,241
Industrial	456,250	451,031	437,853	412,832	398,728	396,534	388,268	399,571	393,905	380,019
Street and athletic	5,638	6,455	5,164	5,255	5,209	5,086	4,973	4,936	4,908	4,783
Outdoor lighting	4,150	4,105	4,139	4,211	4,221	4,297	4,359	4,346	4,340	4,311
Internal use	-	-	-	-	-	-	-	843	901	887
Total consumption	993,660	970,113	969,111	945,935	890,320	914,394	874,590	877,759	873,791	842,735
Line losses and megawatt hours accounted for	45,775	33,805	45,300	51,590	45,165	47,459	43,561	41,937	39,531	39,947
Percentage of line losses and megawatt hours unaccounted for to purchased power	4.40%	3.37%	4.47%	5.17%	4.83%	4.93%	4.74%	4.56%	4.33%	4.53%
Active service (number of customers):										
Residential	28,070	27,760	27,650	27,458	27,360	27,234	26,951	26,603	26,315	25,978
Commercial	3,500	3,425	3,332	3,291	3,304	3,229	3,241	3,144	3,130	3,095
Industrial	622	609	614	591	588	584	551	543	536	510
Street and athletic	40	41	41	41	38	38	38	29	28	28
Outdoor lighting	159	160	161	160	158	161	161	155	157	158
	32,391	31,995	31,798	31,541	31,448	31,246	30,942	30,474	30,166	29,769

Note: Information is compiled from internally generated statistical reports.

Bristol Tennessee Essential Services

Schedule of Bonds Payable by Type

Fiscal Year 2006

Revenue bonds (in thousands)	\$ 24,347
Number of customers	<u>32,391</u>
Outstanding debt per customer	<u>\$ 752</u>

*Note: No outstanding debt existed prior to fiscal year 2006.*

Bristol Tennessee Essential Services

Schedule of Power System Revenue Bond Coverage

Fiscal Year 2006 (in thousands)

Power Operating Revenues	Power Operating Expenses	Net Revenue for Debt Service	Debt Service Requirements			
			Principal	Interest	Total	Coverage
66,376	62,283	4,093	-	627	627	6.53

*Note 1: Power operating expenses do not include depreciation.*

*Note 2: No outstanding debt existed prior to fiscal year 2006.*



# Bristol Tennessee Essential Services

## Schedule of Property, Casualty and Other Insurance (Unaudited)

June 30, 2006

Type of Coverage	Limits	Deductible	Period of Coverage	Company
Theft, disappearance and destruction	\$ 250,000	\$ -	12/04/05 to 12/04/06	Cincinnati Ins. Co.
Workers' compensation	500,000	-	12/04/05 to 12/04/06	Cincinnati Ins. Co.
General liability:		0 to 1,000	12/04/05 to 12/04/06	Cincinnati Ins. Co.
Products-completed operations aggregate	2,000,000			
Personal and advertising injury	1,000,000			
Each occurrence	1,000,000			
Fire damage (any one fire)	100,000			
Medical expense (any one person)	5,000			
Employee benefits:				
Each claim	1,000,000			
Aggregate	3,000,000			
Automobile policy:		100 to 1,000	12/04/05 to 12/04/06	Cincinnati Ins. Co.
Liability	1,000,000			
Comprehensive	Actual Cash Value			
Uninsured motorist	1,000,000			
Collision	Actual Cash Value			
Medical payments	5,000 per person			
Commercial umbrella liability	20,000,000	-	12/04/05 to 12/04/06	Cincinnati Ins. Co.
Fire, extended coverage & vandalism and malicious mischief:		10,000	12/04/05 to 12/04/06	Cincinnati Ins. Co.
On premise property	24,221,514			
Off premise property	250,000			

Bristol Tennessee Essential Services

Schedule of Property, Casualty and Other Insurance (Unaudited) (continued)

June 30, 2006

Type of Coverage	Limits	Deductible	Period of Coverage	Company
Scheduled property floater:				
Flood	\$ 2,000,000	\$ 25,000	12/05/03 to	Cincinnati Ins. Co.
Earthquake	10,000,000	500,000	12/04/05	
Directors & officers liability	10,000,000	0 to 10,000	04/28/05 to 04/28/06	Cincinnati Ins. Co.
Boiler & machinery policy	500,000	5,000 to 12/04/04 to 50,000 12/04/05		Cincinnati Ins. Co.
Employee dishonesty	500,000	1,000	12/04/04 to 12/04/05	Cincinnati Ins. Co.
Electronic data processing equipment and media	628,303	1,000	12/04/04 to 12/04/05	Cincinnati Ins. Co.
Mobile property - machinery	621,126	250	12/04/04 to 12/04/05	Cincinnati Ins. Co.
Employment related practices liability:		2,500	12/04/04 to 12/04/05	Cincinnati Ins. Co.
Each insured event limit	1,000,000			
Total limit	1,000,000			

Note 1: Information is compiled from internal records.

# Bristol Tennessee Essential Services

## Schedule of Electric Rates (Last Ten Years) (Unaudited)

### Fiscal Years 2006 - 1997

	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
<b>Residential</b>										
Monthly customer charge	\$ 6.29	\$ 6.29	\$ 6.29	\$ 5.52	\$ 5.52	\$ 5.52	\$ 5.52	\$ 5.52	\$ 5.52	\$ 5.52
Energy charge:										
First 1,000 kWh per month	0.06352	0.05374	0.05374	0.05018	0.05018	0.05018	0.05018	0.05018	0.05018	0.04818
Additional kWh per month	0.06896	0.05918	0.05918	0.05615	0.05615	0.05615	0.05615	0.05615	0.05615	0.05290
<b>Commercial, Industrial, Governmental and Institutional</b>										
Plan A-1 (demand up to 50 kW and usage up to 15,000 kWh):										
Customer charge per month	14.00	14.00	14.00	10.00	10.00	10.00	10.00	10.00	10.00	6.70
Energy charge	0.07346	0.06240	0.06240	0.05820	0.05820	0.05820	0.05820	0.05820	0.05820	0.05556
Plan A-2 (demand of 50 kW or demand less than 50 kW but usage in excess of 15,000 kWh):										
Customer charge per month	25.00	25.00	25.00	10.00	10.00	10.00	10.00	10.00	10.00	6.70
Demand charge:										
First 50 kW	-	-	-	-	-	-	-	-	-	-
Excess of 50 kW	10.06	8.56	8.56	7.86	7.86	7.86	7.86	7.86	7.86	7.38
Energy charge:										
First 15,000 kWh per month	0.07300	0.06194	0.06194	0.05774	0.05774	0.05774	0.05774	0.05774	0.05774	0.05408
Additional kWh per month	0.04042	0.03420	0.03420	0.03184	0.03184	0.03184	0.03184	0.03184	0.03184	0.02976
Plan A-3 (demand of 1,001 kW to 5,000 kW):										
Customer charge per month	25.00	25.00	25.00	10.00	10.00	10.00	10.00	10.00	10.00	6.70
Demand charge:										
First 1,000 kW	10.14	8.56	8.56	7.89	7.89	7.89	7.89	7.89	7.89	7.38
Excess of 1,000 kW	11.94	10.06	10.06	9.09	9.09	9.09	9.09	9.09	9.09	7.90
Energy charge	0.04042	0.03420	0.03420	0.03184	0.03184	0.03184	0.03184	0.03184	0.03184	0.02976

# Bristol Tennessee Essential Services

## Schedule of Electric Rates (Last Ten Years) (Unaudited) (continued)

Fiscal Years 2006 - 1997

	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
<b>Commercial, Industrial, Governmental and Institutional (continued)</b>										
<b>Plan B (demand of 5,001 kW to 15,000 kW)</b>										
Customer charge per month	1,500.00	1,500.00	1,500.00	1,500.00	1,500.00	1,500.00	1,500.00	1,500.00	1,500.00	1,500.00
Demand charge	12.89	10.96	10.96	10.23	10.23	10.23	10.23	10.23	10.23	9.57
<b>Energy charge:</b>										
First 620 kWh per month	0.03588	0.03050	0.03050	0.02825	0.02825	0.02825	0.02825	0.02825	0.02825	0.02637
Additional kWh per month	0.02928	0.02477	0.02477	0.02306	0.02306	0.02306	0.02306	0.02306	0.02306	0.02152
<b>Plan C (demand of 15,001 kW to 25,000 kW)</b>										
Customer charge per month	1,500.00	1,500.00	1,500.00	1,500.00	1,500.00	1,500.00	1,500.00	1,500.00	1,500.00	1,500.00
Demand charge	13.00	11.07	11.07	10.34	10.34	10.34	10.34	10.34	10.34	9.68
<b>Energy charge:</b>										
First 620 kWh per month	0.03588	0.03035	0.03035	0.02825	0.02825	0.02825	0.02825	0.02825	0.02825	0.02637
Additional kWh per month	0.02928	0.02477	0.02477	0.02306	0.02306	0.02306	0.02306	0.02306	0.02306	0.02152
<b>Plan D (demand in excess of 25,000 kW)</b>										
Customer charge per month	-	-	-	1,500.00	1,500.00	1,500.00	1,500.00	1,500.00	1,500.00	1,500.00
Demand charge	-	-	-	12.60	12.60	12.60	12.60	12.60	12.60	11.78
Energy charge	-	-	-	0.02265	0.02265	0.02265	0.02265	0.02265	0.02265	0.02114

Note 1: Summarized from internal records.

Bristol Tennessee Essential Services

Schedule of Cable and Internet Rates (Unaudited)

June 30, 2006

**Cable Television**

Expanded Basic	\$ 39.95
Digital:	
Basic	49.95
Bronze	59.95
Silver	67.95
Gold	72.95
High Definition Tier	6.95
Sports Tier	4.00
Pay-Per-View Movies:	
New release	3.95
Library	2.95
Premium Packages:	
Cinemax	9.95
HBO	11.95
Showtime	11.95
STARZ	9.95

**Internet**

Dial-up	16.95
Fiber Optic:	
64K Tier	16.95
1Mbps Tier	29.95
2Mbps Tier	39.95
4Mbps Tier	49.95

*Note 1: Cable and Internet services commenced in 2006.*

*Note 2: Summarized from internal records.*

*Note 3: Telephone service is expected to commence in 2007.*

Bristol Tennessee Essential Services

Schedule of Principal Customers Ranked by Kwh Usage (Unaudited)

Current Year and Nine Years Ago

<b>Name</b>	<b>2006 Rank</b>	<b>1997 Rank</b>
Exide Corporation	1	1
City of Bristol, Tennessee	2	5
Modern Forge of Tennessee	3	4
Wellmonth BRMC	4	3
GlaxoSmithKline Laboratories	5	6
King Pharmaceuticals	6	—
Amerace Corporation	7	9
Bristol Metals, Inc.	8	7
Royal Mouldings	9	—
Seaman Corporation	10	—
Raytheon Company	—	2
Fingerhut	—	8
Sprint	—	10

*Note 1: Summarized from internal records.*

Bristol Tennessee Essential Services

Schedule of Employees (Last Ten Years) (Unaudited)

Fiscal Years 2006 - 1997

<b>Fiscal Year</b>	<b>Full Time</b>	<b>Part Time</b>	<b>Total</b>
<b>2006</b>	<b>60</b>	<b>5</b>	<b>65</b>
2005	60	5	65
2004	60	8	68
2003	60	9	69
2002	60	5	65
2001	60	6	66
2000	60	6	66
1999	62	6	68
1998	62	6	68
1997	55	6	61

*Note 1: Summarized from internal records.*

**BRISTOL TENNESSEE ESSENTIAL SERVICES****STATISTICS - JUNE 2006**

2470 Volunteer Parkway, Bristol, TN 37620

P. O. Box 549, Bristol, TN 37621

Telephone: 423-968-1526

FAX Number: 423-793-5545

Power Outage Number: 423-968-BTES (968-2837)

Miles of Line .....1,239

**NUMBER OF POWER CUSTOMERS**

Large General Power (&gt;50 kW) .....622

Small General Power (&lt;50 kW).....3,500

Residential .....28,070

Street and Outdoor Lighting ..... 199

**Total** .....**32,391****Employees/1000 Customers** .....**1.9****NUMBER OF FIBER OPTIC CUSTOMERS**

Residential Cable Television Customers..... 1,316

Commercial Cable Television Customers..... 40

Residential Internet Customers..... 802

Commercial Internet Customers..... 41

**Total Services** ..... **2,199****Total Homes and Businesses Served**..... **1,455**



**BRISTOL TENNESSEE ELECTRIC SYSTEM  
CLIMATOLOGICAL DATA  
FISCAL YEARS 2006-1997**

<b>Fiscal Year</b>	<b>Heating Degree Days *</b>	<b>Cooling Degree Days *</b>
2006	4038	1163
2005	4222	1068
2004	4141	1027
2003	4064	1132
2002	3921	1189
2001	4539	933
2000	4019	1082
1999	4312	951
1998	4142	904
1997	4446	749

SOURCE: U.S. Department of Commerce, National Oceanic and  
Atmospheric Administration

\* Degree Day is a unit of measuring the extent to which the outdoor mean temperature falls below (heating) or rises above (cooling) the base of 65 degrees Fahrenheit. One degree day is counted for each degree of deficiency below (heating) or excess over (cooling) the base, for each calendar day on which such deficiency of excess occurs.

**BRISTOL TENNESSEE ELECTRIC SYSTEM  
DEMOGRAPHIC AND ECONOMIC STATISTICS  
TRI-CITIES, TENNESSEE-VIRGINIA MSA  
CALENDAR YEARS 2005-1996**

<b>Calendar Year</b>	<b>Population</b>	<b>Per Capita Income</b>	<b>Median Age</b>	<b>Unemployment Rate</b>
2005	490,238	\$27,163	42.0	4.6%
2004	479,830	\$25,299	39.6	4.8%
2003	485,884	\$23,878	39.2	5.9%
2002	485,300	\$22,302	40.2	5.3%
2001	484,900	\$22,302	39.7	5.0%
2000	480,091	\$22,119	39.7	4.5%
1999	465,700	\$21,201	39.4	4.4%
1998	464,900	\$19,896	39.1	4.4%
1997	459,963	\$19,503	37.6	4.1%
1996	458,229	\$18,932	37.8	4.7%

Information obtained from First Tennessee Development District.

Information for 2006 is not available.



Report on Internal Control Over Financial Reporting and on Compliance and  
Other Matters Based on an Audit of Financial Statements Performed in  
Accordance with *Government Auditing Standards*

Board of Directors  
Bristol Tennessee Essential Services

We have audited the financial statements of the Bristol Tennessee Essential Services ("BTES"), formerly Bristol Tennessee Electric System, an enterprise fund of the City of Bristol, Tennessee, as of and for the year ended June 30, 2006, and have issued our report thereon dated October 20, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered BTES' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether BTES' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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This report is intended solely for the information and use of the Board of Directors, management and the State of Tennessee Comptroller of the Treasury and is not intended to be and should not be used by anyone other than these specified parties.

*Coulter & Justus, P.C.*

October 20, 2006