ELIZABETHTON ELECTRIC
Finance (423)542-1100
Operations (423)542-1101
PO Box 790
Elizabethton, TN 37643

ELIZABETHTON ELECTRIC DEPARTMENT

AN ENTERPRISE FUND OF THE

CITY OF ELIZABETHTON, TENNESSEE

AUDITED FINANCIAL STATEMENTS

For the Fiscal Year Ending June 30, 2011

Blackburn, Childers & Steagall, PLC
Certified Public Accountants and Consultants
www.BCScpa.com

CITY OF ELIZABETHTON ELECTRIC DEPARTMENT

AN ENTERPRISE FUND OF THE CITY OF ELIZABETHTON, TENNESSEE

FINANCIAL STATEMENTS AND SUPPLEMENTAL INFORMATION

WITH

INDEPENDENT AUDITORS' REPORT

For the Fiscal Year Ended June 30, 2011

CITY OF ELIZABETHTON ELECTRIC DEPARTMENT
AN ENTERPRISE FUND OF THE CITY OF ELIZABETHTON, TENNESSEE
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For the Fiscal Year Ended June 30, 2011

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FINANCIAL SECTION

Blackburn, Childers & Steagall, PLC

Certified Public Accountants and Consultants
American Institute of Certifed Public Accountants

Celebrating Our 50th Anniversary

INDEPENDENT AUDITORS' REPORT

Honorable Mayor, City Council Members and
City Manager
City of Elizabethton Electric Department
Elizabethton, Tennessee 37643

We have audited the accompanying financial statements of the City of Elizabethton Electric Department, an enterprise fund of the City of Elizabethton, Tennessee, as of and for the year ended June 30, 2011, as listed in the table of contents. These financial statements are the responsibility of the City of Elizabethton, Tennessee's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

As discussed in Note 1, the basic financial statements present only the City of Elizabethton Electric Department and do not purport to, and do not, present fairly the financial position of the City of Elizabethton, Tennessee, as of June 30, 2011, and the changes in its financial position and cash flows for the year 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 the City of Elizabethton Electric Department, an enterprise fund of the City of Elizabethton, Tennessee, as of June 30, 2011, and the changes in financial position and cash flows for the year 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 December 6, 2011 on our consideration of the City of Elizabethton Electric Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Johnson City	801B Sunset Drive, Johnson City, TN 37604	(423) 282-4511	Fax (423) 283-4532
Kingsport	440 E. Sullivan Street, Kingsport, TN 37660	(423) 246-1725	Fax (423) 247-6800
Greeneville	550 Tusculum Boulevard, Greeneville, TN 37745	(423) 638-8516	Fax (423) 638-3361

website: http://www.BCScpa.com e-mail: BCS@BCScpa.com

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and schedules of funding progress and funding progress of post retirement benefits other than pensions on pages 3 through 7 and 31 through 32 be presented to supplement the basic financial statements. Such information, although not a required part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquires of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the City of Elizabethton Electric Department, an enterprise fund of the City of Elizabethton, Tennessee's financial statements as a whole. The supplemental schedules are presented for purposes of additional analysis and are not a required part of the financial statements. The supplemental schedules, except for the Ratio of Outstanding Debt by Type, Number of Electric Customers by Type, and Electricity Rates are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole. The Ratio of Outstanding Debt by Type, Number of Electric Customers by Type, and Electricity Rates have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

Blackburn, Childers + Steagall, PLC
BLACKBURN, CHILDERS & STEAGALL, PLC

December 6, 2011

The following is the Management's Discussion and Analysis (MD&A) of the financial statements and supporting documents for the Elizabethton Electric Department, an enterprise fund of the City of Elizabethton, Tennessee for the fiscal year ended June 30, 2011.

This MD&A should be read in conjunction with the financial statements and all supporting documents that follow this analysis.

Elizabethton Electric provides electric power to over 25,000 customers in a distribution area covering over 150 square miles in Northeast Tennessee that includes the City of Elizabethton, Town of Watauga and parts of Johnson City. Elizabethton Electric also serves Carter and parts of Sullivan, Unicoi and Washington counties.

Overview of the Financial Statements

The annual report consists of three sections. Section I includes the independent auditor's report, the basic financial statements, including the Statement of Net Assets, Statement of Revenues, Expenses and Changes in Net Assets, the Statement of Cash Flows, and the notes to the basic financial statements. Section II includes all supplemental information.

The financial statements are prepared using the accrual basis of accounting. All short-term assets and long-term assets are recorded. Revenues are recorded when earned and expenses are recorded when a liability is incurred regardless of the timing of related cash flows.

Section III includes the report on Internal Control and Compliance.

Elizabethton Electric Department Activity Highlights

The Elizabethton Electric Department had an overall small decrease in customer growth this year. The flowing chart shows the number of customers for each classification for the past two years.

	2011	2010
Residential	22,717	22,605
Small Commercial	2,825	2,996
Large Commercial/Industrial	273	267
Street and Athletic Lighting	37	37
Outdoor Lighting Only	135	117
Total	25,987	26,022

As indicated by the above chart, Residential and Large Commercial/Industrial have increased .50% and 2.25% respectively over the past year. Small Commercial decreased 5.7% and all customers decreased 0.13%.

Capital Assets

The Elizabethton Electric Department has implemented an infrastructure improvement program, which was developed from our 10 Year System study. The study was conducted to reveal any potential delivery issues and help plan for growth in the upcoming years as indicated in the following chart:

	2011	2010
Transmission Plant	$ 8,879,618	8,849,696
Distribution Plant	46,197,211	43,301,090
General Plant	7,555,251	7,486,372
Construction Work in Progress	23,313,794	18,301,304
	$ 85,945,874	77,938,462

The Construction Work in Progress account includes the total of the balances of work orders for electric plan in process of construction. This account also includes capitalized interest in order to show the relationship between the costs of borrowing and the fixed assets the debt used to fund.

In 2010 The Elizabethton Electric Department received a bond, $20,585,000, to rebuild and upgrade significant power lines and substation construction. The work has continued through 2011.

Debt

The Elizabethton Electric Department currently has three bond issues outstanding. One in 2005, $3,495,000, refunding issue that will be paid in full in 2023. One in 2007, $15,000,000, that was issued to update and improve three of our substations that will be paid in full in 2028. The third bond, as mentioned above, was issued in 2010, $20,585,000, to upgrade and rebuild substations and significant power lines and will be paid in full in 2035.

Summary of Changes in Net Assets

		2011	2010
Operating Revenues	$	57,456,596	49,208,207
Operating Expenses		52,376,651	46,074,668
Operating Income Before Depreciation and Amortization		5,079,945	3,133,539
Less: Depreciation		(1,717,862)	(1,653,467)
Operating Income		3,362,083	1,480,072
Non-operating Revenues (Expenses)		(995,369)	(813,667)
Transfers		(616,286)	(605,496)
Change in Net Assets	$	1,750,428	60,909

Operating and Non-operating High Revenue Highlights

The following schedule presents a summary of revenues for the fiscal years ended June 30:

Operating Revenues

		2011		2010
Electric Sales Revenue	$	56,061,815		47,364,449
Revenue from Late Payments		354,541		303,926
Miscellaneous Service Revenues		316,112		371,220
Rent from Electric Property		724,128		1,168,612
Total Operating Revenues		57,456,596		49,208,207
Other Income		37,346		108,062
Total Revenues	$	57,493,942	$	49,316,269

Included in Electric Sales Revenues is Unbilled Revenue or the estimation of electricity used, but not billed.

- Electric sales revenue increased by 18% over the prior year.
- Revenue from late payments increased by 17% over the prior year.
- Rent from electric property due to billing of pole attachment fees decreased by 38% over the prior year.

Operating and Maintenance Expense

Operations		2011	2010
Purchased Power	$	45,453,172	37,956,861
Transmission Expense		99,977	9,449
Distribution Expense		882,327	939,829
Customer Accounts Expense		970,536	1,222,166
Sales Expense		88,535	96,369
Administrative & General Expense		2,191,310	2,020,516
		49,685,857	42,245,190
Maintenance			
Transmission Expense		142,126	156,127
Distribution Expense		2,110,278	3,130,991
Administrative & General Expense		72,593	87,588
	$	2,324,997	3,374,706
Other			
Depreciation and Taxes	$	2,083,659	2,108,239
Interest Expense		1,032,715	921,729
		3,116,374	3,029,968
Total Expenses		55,127,228	48,649,864
Transfers		(616,286)	(605,496)
Change in Net Assets	$	1,750,428	60,909

- Operation Expenses increased by 18% over the prior year.
- Maintenance Expense decreased by 31%.
- Interest Expense increased due to the issuance of the 2010 bond.

Financial Position Summary

A condensed summary of the Elizabethton Electric Department's total net assets for the fiscal years ended June 30:

Financial Position Summary		2011	2010
Current Assets	$	26,112,256	26,704,292
Restricted Assets		2,231,188	2,173,272
Capital Assets (net)		63,666,496	56,198,898
Other Assets		2,507,516	2,493,200
Total Assets	$	94,517,456	87,569,662
Current Liabilities	$	12,907,743	7,180,954
Non-current Liabilities		39,030,118	40,087,666
Total Liabilities		51,937,861	47,268,620
Net Assets Invested in Capital Assets, Net of Related Debt		25,881,750	18,154,567
Unrestricted Net Assets		16,697,845	22,146,475
Total Net Assets		42,579,595	40,301,042
Total Liabilities and Net Assets	$	94,517,456	87,569,662

EED adjusted off prior year accrual for sick leave given the court decision/final ruling that voided sick leave claims.

The financial report is designed to provide a general overview of the Elizabethton Electric Department's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in the report or requests for additional information should be addressed to the Financial Director, City of Elizabethton, 136 S. Sycamore Street, Elizabethton, TN 37643.

CITY OF ELIZABETHTON ELECTRIC DEPARTMENT
AN ENTERPRISE FUND OF THE CITY OF ELIZABETHTON, TENNESSEE
STATEMENT OF NET ASSETS
June 30, 2011

ASSETS	
Current Assets	
Cash on Hand	$ 17,095
Cash in Bank	4,778,003
Certificates of Deposit	1,351,466
Investments	13,796,148
Accounts Receivable	
Customer Service	2,373,119
Interest, Rents and Other	2,763,740
Allowance for Uncollectible Amounts	(142,131)
Due from Other Funds	148,648
Inventories	1,026,168
Total Current Assets	26,112,256
Non-Current Assets	
Capital Assets	
Capital Assets, Not Depreciated	23,907,988
Capital Assets, Depreciated	62,037,886
Accumulated Depreciation	(22,279,378)
Net Capital Assets	63,666,496
Other Assets	
Restricted Cash in Bank - Customer Deposits	2,231,188
Accounts Receivable - Customers - Energy Right	1,569,857
Due from Other Funds	61,920
Unamortized Bond Issue Costs (Net)	848,396
CSA Stockholder Loan	27,343
Total Other Assets	4,738,704
Total Non-Current Assets	68,405,200
TOTAL ASSETS	94,517,456

(Continued)

CITY OF ELIZABETHTON ELECTRIC DEPARTMENT
AN ENTERPRISE FUND OF THE CITY OF ELIZABETHTON, TENNESSEE
STATEMENT OF NET ASSETS
June 30, 2011

LIABILITIES	
Current Liabilities	
Accounts Payable	7,319,921
Accrued Wages	2,330
Accrued Interest	636,247
Accrued Taxes	137,052
Bonds Payable	760,000
Compensated Absences	111,717
Due to Other Funds	154,090
Customer Deposits Payable from Restricted Cash	2,231,188
Other Current and Accrued Liabilities	1,555,198
Total Current Liabilities	12,907,743
Non-Current Liabilities	
Compensated Absences	163,562
Bonds Payable (Net of Deferred Funding Cost and Bond Discount)	37,024,746
OPEB Liability	271,953
Advance from TVA	1,569,857
Total Non-Current Liabilities	39,030,118
TOTAL LIABILITIES	51,937,861
NET ASSETS	
Invested in Capital Assets, Net of Related Debt	25,881,750
Unrestricted	16,697,845
TOTAL NET ASSETS	$ 42,579,595

The notes to the financial statements are an integral part of this statement.

CITY OF ELIZABETHTON ELECTRIC DEPARTMENT
AN ENTERPRISE FUND OF THE CITY OF ELIZABETHTON, TENNESSEE
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
For the Fiscal Year Ended June 30, 2011

OPERATING REVENUES	
Sales of Electric Energy	
Residential	$ 36,389,623
Small Lighting and Power	4,933,634
Large Commercial and Industrial	13,570,064
Street and Outdoor Lighting	1,168,494
Other Operating Revenues	1,394,781
Total Operating Revenues	57,456,596
OPERATING EXPENSES	
Operation	
Power Purchased from Tennessee Valley Authority	45,453,172
Other Operation Expenses	4,232,685
Maintenance	2,324,997
Provision for Depreciation	1,717,862
Tax and Tax Equivalents	365,797
Total Operating Expenses	54,094,513
Operating Income	3,362,083
NONOPERATING REVENUES (EXPENSES)	
Interest on Invested Funds	37,346
Interest Expense	(995,600)
Amortization Expense	(37,115)
Total Nonoperating Revenues (Expenses)	(995,369)
Income Before Transfer	2,366,714
Transfer Out	(616,286)
Change in Net Assets	1,750,428
Net Assets, July 1, 2010	40,301,042
Prior Period Adjustment	528,125
NET ASSETS, JULY 1, 2010 - RESTATED	40,829,167
NET ASSETS, JUNE 30, 2011	$ 42,579,595

The notes to the financial statements are an integral part of this statement.

CITY OF ELIZABETHTON ELECTRIC DEPARTMENT
AN ENTERPRISE FUND OF THE CITY OF ELIZABETHTON, TENNESSEE
STATEMENT OF CASH FLOWS
For the Fiscal Year Ended June 30, 2011

CASH FLOWS FROM OPERATING ACTIVITIES	
Cash Received from Electric Sales	$ 54,637,958
Cash Received from City of Elizabethton, Tennessee	909,895
Cash Received from Rentals and Other Sales	1,234,775
Cash Payments to Suppliers for Goods and Services	(46,121,345)
Cash Payments for Employee Services and Benefits	(847,787)
Cash Payments for Tax Equivalents	(205,322)
Cash Paid to Lender On Behalf of Energy Right Customers	(615,741)
Cash Received on Loans by Energy Right Customers	519,634
Net Cash Provided by (Used for) Operating Activities	9,512,067
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Transfer to Other Fund	(616,286)
Net Cash Provided by (Used For) Noncapital Financing Activities	(616,286)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Acquisition and Construction of Capital Assets	(8,776,046)
Principal Paid on Revenue Bonds	(735,000)
Interest Paid on Revenue Bonds	(742,822)
Net Cash Provided by (Used For) Capital and Related Financing Activities	(10,253,868)
CASH FLOWS FROM INVESTING ACTIVITIES	
Interest on Certificates of Deposit	120,335
Purchase of Certificates of Deposit and Investments	(1,166,702)
Sale of Certificates of Deposit and Investments	9,413,583
Net Cash Provided by (Used for) Investing Activities	8,367,216
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	7,009,129
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	17,157
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 7,026,286

(Continued)

CITY OF ELIZABETHTON ELECTRIC DEPARTMENT
AN ENTERPRISE FUND OF THE CITY OF ELIZABETHTON, TENNESSEE
STATEMENT OF CASH FLOWS
For the Fiscal Year Ended June 30, 2011

Reconciliation of Operating Income (Loss) to
Net Cash Provided by (Used for) Operating Activities:

Operating Income (Loss)	$	3,362,083
Adjustments		
Depreciation		1,836,573
Provision for Uncollectible Accounts		(60,373)
(Increase) Decrease in Assets		
(Increase) Decrease in Accounts Receivable-Customer		177,781
(Increase) Decrease in Accounts Receivable-Other		(909,774)
(Increase) Decrease in Inventories		12,627
Increase (Decrease) in Liabilities		
Increase (Decrease) in Accounts Payable		4,525,821
Increase (Decrease) in Other Liabilities		1,469,931
Increase (Decrease) in Accrued Salaries		(82,855)
Increase (Decrease) in Compensated Absences		(604,458)
Increase (Decrease) in Cash Overdraft		(243,338)
Increase (Decrease) in OPEB Liability		66,130
Increase (Decrease) in Customer Deposits		58,026
Increase (Decrease) in Energy Right Loans		(96,107)
Net Cash Provided by (Used for) Operating Activities	$	9,512,067

Reconciliation of Cash and Cash Equivalents to Statement of Net Assets

Cash on Hand	$	17,095
Cash in Bank		4,778,003
Restricted Cash in Bank - Customer Deposits		2,231,188
Total Cash and Cash Equivalents	$	7,026,286

The notes to the financial statements are an integral part of this statement.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

City of Elizabethton Electric Department (the Department) is a utility furnishing electrical power to Carter County and portions of other Upper East Tennessee counties. The Department purchases its electrical power from the Tennessee Valley Authority (TVA).

The Department is a fund of the City of Elizabethton, Tennessee. These financial statements include only the statements of the Department and not the City of Elizabethton, Tennessee, as a whole.

The financial statements of the Department have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. GASB statement No. 20 gives governments the option of applying all Financial Accounting Standards Board (FASB) statements and interpretations issued after November 30, 1989, to its proprietary funds, unless they conflict with or contradict GASB pronouncements. The City of Elizabethton, Tennessee has elected not to implement FASB statements and interpretations issued thereafter, unless they are adopted by GASB.

The Department does not have any net assets restricted via constraints. Accordingly, the Department's net assets are categorized as invested in capital assets, net of related debt and unrestricted. The unrestricted category includes the sinking fund which was established by the Department to set aside funds for payment of bonds related to capital improvements and extensions of the Department.

Basis of Accounting

"Basis of Accounting" refers to the timing of recognizing revenues and expenses in the financial statements. The accompanying financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues and related assets are recognized when earned, and expenses are recognized when obligations are incurred regardless of the timing of related cash flows.

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.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Operating Revenues and Expenses

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing connection. The principal operating revenues of the Department are charges to customers for sales and services. Operating expenses for the Department include the cost of sales and services, administrative expenses, amortization and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Restricted Assets

The Department's restricted assets consist of cash on deposit in the amount of $2,231,188, which are restricted for the payment of customer deposits.

Deposits and Investments

Cash on the statement of cash flows includes cash on hand and demand deposits in local banks.

Various restrictions on deposits and investments, including repurchase agreements, are imposed by state statutes. These restrictions are summarized as follows.

DEPOSITS - All deposits with financial institutions must be collateralized in an amount equal to 105% of the market value of uninsured deposits.

INVESTMENTS - The Department is authorized to make direct investments in bonds, notes or treasury bills of the U. S. Government and obligations guaranteed by the U. S. Government or any of its agencies. These investments may not have a maturity greater than two years. The Department may make investments with longer maturities if it follows various restrictions established by state law. The Department is also authorized to make investments in the State Pooled Investment Fund and in repurchase agreements. Repurchase agreements must be approved by the State Director of Local Finance and executed in accordance with procedures established by the State Funding Board. Investments are reported at fair value.

Securities purchased under a repurchase agreement must be obligations of the U. S. Government or obligations guaranteed by the U. S. Government or any of its agencies. When repurchase agreements are executed, the purchase of the securities must be priced at least 2% below the market value of the securities on the day of purchase. No repurchase agreements existed as of June 30, 2011.

The carrying amount of the Department's deposits with financial institutions was $7,009,191 and the financial institution balance was $7,195,994. Carrying amounts differ from the financial institution balances primarily due to outstanding checks and deposits in transit.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Deposits and Investments (Continued)

All deposits are insured with FDIC insurance. Amounts in excess of FDIC coverage are secured by the financial institution through the State Collateral Pool.

Certificates of deposit with original maturities greater than 90 days are recorded as Certificates of Deposit with a balance of $1,351,466. These certificates are stated at cost which approximates fair value and are not included as cash and cash equivalents because the original maturity exceeds 90 days. At June 30, 2011, these are insured with FDIC insurance and the excess is secured by the financial institution through the State Collateral Pool. The Department does not have a policy for interest rate risk or credit risk other than pledging securities for amounts in excess of the FDIC coverage.

Investments

The Department invests funds in the State of Tennessee's Local Government Investment Pool and bond proceeds with an investment advisor. The Department's interest in the Investment Pool is recorded at fair market value and at June 30, 2011, funds were $1,464,175. This is included as Investments on the Statement of Net Assets. The total investment with the investment firm is recorded at fair value and is $12,331,973 at June 30, 2011 and is included as Investments on the Statement of Net Assets.

Disclosures Relating to Interest Rate and Credit Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the Department manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is the measure by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating required for each investment type.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Deposits and Investments (Continued)

As of June 30, 2011, the Department had the following investments.

	Carrying Amount	Market Value
Local Government Investment Pool	$ 1,464,175	1,464,175
Bond Fund Investments		
Municipal Securities	7,832,063	7,832,063
Treasury Securities	4,499,910	4,499,910
Total Bond Fund Investments	12,331,973	12,331,973
Total Investments	$ 13,796,148	13,796,148

The Department's bond fund investments had the following credit risk structure as of June 30, 2011:

Investment Type	Moody's Credit Rating	Fair Value	Percent of Total
Municipal Securities			
Taxable Municipals	Aa2	$ 1,241,272	10%
Taxable Municipals	Aa3	751,747	6%
Taxable Municipals	Aaa/AAA	151,017	1%
Taxable Municipals	Unrated	750,508	6%
Taxable Municipals	MIG1	497,947	4%
Tax-free Municipals	Aaa/AAA	333,028	3%
Tax-free Municipals	Aaa/AA+	200,150	2%
Tax-free Municipals	Aa1	1,060,927	9%
Tax-free Municipals	Aa2	823,508	7%
Tax-free Municipals	Aa3	938,494	8%
Tax-free Municipals	AA	136,375	1%
Tax-free Municipals	SP1+	499,870	4%
Tax-free Municipals	Unrated	447,220	4%
		7,832,063	
Treasury Securities			
U.S. Treasury Bill	Unrated	4,499,910	36%
Total Bond Fund Investments		$ 12,331,973	

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Deposits and Investments (Continued)

The Department's investment maturities by type are as follows:

		Investment Maturities (in Years)			
Investment Type	Fair Value	Less than 1	1 - 5	6 - 10	More Than 10
Municipal Securities	$ 7,832,063	7,832,063	-	-	-
Treasury Securities	4,499,910	4,499,910	-	-	-
Total Bond Fund Investments	$ 12,331,973	12,331,973	0	0	0

Inventories

Materials and supplies inventories are stated at average cost on a per item basis.

Capital Assets

Land, buildings, machinery and equipment, and electrical distribution systems are stated at historical cost. Expenses for maintenance and repairs, which do not improve or extend the life of the asset, are charged to expense as incurred. Interest incurred during the construction of large projects is reflected in the capitalized value of the project. The assets are being depreciated on the straight-line method over the useful lives per guidelines of the TVA. 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 as per federal energy regulations. The depreciation expense for the year ended June 30, 2011 was $1,836,573 of which $118,711 was charged to transportation expense.

The estimated useful lives of the utility plant of the City of Elizabethton Electric Department are as follows:

Class Description	Estimated Useful Life
Buildings	50.2 years
Office Equipment	20.0 years
Transportation Equipment	5.0 to 10.0 years
Other Machinery and Equipment	12.5 to 20.0 years
Power Distribution Department	12.5 to 44.44 years

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Compensated Absences

Accumulated Vacation:
Employees earn various days of vacation based on the number of years of service. Employees with more than 20 years of service are entitled to a maximum of 25 days of vacation per year. A maximum of 30 days of accumulated vacation may be carried to the next calendar year. Vacation time accumulated prior to January 1, 1978 is exempt from the carry-forward limitation and capped at that balance. At the end of December 31 of each year, accumulated vacation leave in excess of 30 days may be paid in cash. All accumulated vacation leave will be paid upon separation of service. Also, one additional day will be given each year for a year's service without a lost-time accident or without taking a day of sick leave.

A liability for compensated absences and related fringe benefits is reflected on the statement of net assets at June 30, 2011, in the amount of $275,279. The portion of this liability expected to be paid within one year is classified as a current liability and the remainder as a long-term liability.

Power Contract

The Department has a power contract with the TVA whereby the Department 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 upon not less than five years prior written notice.

Budgets

The City of Elizabethton Electric Department is not required to demonstrate statutory compliance with budgets. Accordingly, budgetary data is not included in the financial statements. All budgets are prepared in accordance with bond covenants. Unexpended appropriations lapse at year end.

Transfer

The City of Elizabethton Electric Department transferred $616,286 to the City of Elizabethton's general fund for a payment in lieu of taxes.

NOTE 2 - LITIGATION

The Department has claims against it as of June 30, 2011 and discovery is on-going. Additional contingencies include worker compensation claims that are being handled by an attorney chosen by the Tennessee Municipal League.

NOTE 3 - RISK COVERAGE

The Department has provided for coverage of the risks of loss through the purchase of commercial insurance. The coverage has been approximately the same for the past three years and there have been no settlements in excess of coverage during the past three years.

NOTE 4 - ACCOUNTS RECEIVABLE

Accounts Receivable at year end were as follows:

Customer Service	$ 2,373,119
Rent	525,066
Interest	42,971
Unbilled Revenue	1,929,960
Miscellaneous Billing	265,743
	5,136,859
Less: Allowance for Uncollectible Amounts	(142,131)
	$ 4,994,728

The allowance for uncollectible amounts is an estimate established by a review of account history and knowledge of the industry. Accounts are directly written off once all methods of collection have been exhausted.

NOTE 5 - POST-RETIREMENT BENEFITS OTHER THAN PENSIONS

A Brief Description of the Retiree Medical and Life Insurance Plan:

Plan Types:

The City of Elizabethton, Tennessee will pay up to the level of the single premium paid for full time city employees until the retiree reaches age 65. The actuarial valuation assumes the City will pay 98% of the single premium, which is the current level paid by the City for full-time employees.

The City of Elizabethton, Tennessee offers post-employment health care benefits to certain eligible employees. Full service eligible retirees are those age 60 or older with a minimum of 5 years of creditable city service at retirement, or retiring at any age with at least 30 years of service. Early retirees are those age 55 or older with a minimum 10 years of creditable city service at retirement, or retiring at any age with at least 25 years of service. For the Electric Department, there are 19 employees covered by this arrangement. The co-insurance rate of reimbursement depends on the plan the employee is covered by. The base plan has a $1,500 deductible and out-of-pocket max of $3,000 with an 80% co-insurance rate. The buy up plan has a $750 deductible and out-of pocket max of $1,500 with an 80% co-insurance rate. During the fiscal year ending June 30, 2011, contributions received from employees was $168,283 and contributions received from retirees were $6,198.

Full time employees who retire after attaining eligibility for either full service or retirement are eligible to receive retirement benefits referred to as a retirement bonus and retirement gift. The amount of the retirement bonus is equal to $2,500 for full service retirement with less than twenty years of service, $3,000 with twenty to thirty years of service or $3,500 with thirty or more years of service. The amount of the retirement bonus is equal to $2,500 for early retirement. This benefit is paid in the form of single sum payment upon retirement. An additional retirement gift of $25 per year of service is paid at the time of retirement to any employee retiring with a full service, early or disability retirement. Benefits are currently funded on a pay as you go basis. For purposes of reporting, the liability for such benefits are included in the Net OPEB Obligation as reflected on the Statement of Net Assets. An actuary study was performed and dated July 1, 2010 for these benefits and the same assumptions as disclosed for the retiree medical and life insurance plan were used.

NOTE 5 - POST-RETIREMENT BENEFITS OTHER THAN PENSIONS (CONTINUED)

Funding Policy:

The contribution requirements of plan members are based on pay-as-you go financing requirements.

Annual OPEB Cost and Net OPEB Obligation:

The Electric Department's other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (of funding excess) over a period not to exceed thirty years. The following table shows the components of the Electric Department's costs for the year, the amount actually contributed to the plan, and changes in the Electric Department's OPEB obligation.

Annual OPEB Cost and Net OPEB Obligation	
Annual Required Contribution (ARC)	$ 185,008
Interest on Net OPEB Obligation	8,233
Adjustment to ARC	(12,352)
Annual OPEB Cost (Expense)	180,889
Contribution Made (assumed end of year)	114,759
Increase in Net OPEB Obligation	66,130
Net OPEB Obligation - Beginning of Year	205,823
Net OPEB Obligation - End of Year	$ 271,953

The annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for fiscal years 2011, 2010 and 2009 are as follows:

Fiscal Year Ending	Annual OPEB Cost	Annual OPEB Cost Contributed	Net OPEB Obligation
6/30/2011	$ 180,889	62%	$ 271,953
6/30/2010	$ 184,288	41%	$ 205,823
6/30/2009	$ 184,288	48%	$ 97,472

NOTE 5 - POST-RETIREMENT BENEFITS OTHER THAN PENSIONS (CONTINUED)

Funded Status and Funding Progress:

As of July 1, 2010, the most recent actuarial valuation date, the plan was not funded. The actuarial accrued liability for benefits was $1,892,996. The covered payroll was $2,412,356 and the ratio of the unfunded actuarial accrued liability (UAAL) to the covered payroll was 78.4%. The funding ratio is 0%.

Actuarial valuations of an ongoing plan involved estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions:

Projects of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations. The following methods and assumptions were used.

The valuation date is July 1, 2010 and year 1 represents the period of July 1, 2010 to June 30, 2011. A discount rate of 4.0% was used to discount expected liabilities to the valuation dates. Future salaries are expected to increase at an annual rate of 3.0%. Average health care trend costs rates are assumed to increase by 10% (year 1), 9.5% (year 2), 9% (year 3), 8.5% (year 4), 8% (years 5 and 6), 7.5% (years 7 and 8), 7% (years 9 and 10), 6.5% (years 11 and 12), 6% (years 13 and 14) and 5.5% thereafter. The ARC was calculated using the level dollar amortization method, amortizing costs over 30 years on a closed basis.

NOTE 6 - RETIREMENT COMMITMENTS

On October 1, 2005, the Department withdrew from the CSA Non Governmental Plan in a spin off whereby assets and liabilities were transferred into the Central Service Association Pension Plan for Governmental Employees. This is a new tax-qualified multiple employer defined benefit pension plan that is maintained as a governmental plan (as defined under section 414(d) of the Internal Revenue Code).

The plan covers all employees over 21 years of age with six months of service. The total contribution by both the Employer and Employees for the plan year ended September 30, 2010 and 2009 were $758,605 and $703,981. The recommended contribution was $800,282 and $818,112 for the plan years October 1, 2010 and 2009 respectively. Covered employees are required to contribute 1½ % of their monthly earnings to the plan. The Department is required to contribute the remaining amount necessary to fund pension cost accrued including amortization of unfunded prior service cost over a period not to exceed 30 years. Any changes to the plan would need to be approved by the Board for the Department and CSA. The investment assumption is 7%, salary assumption is 3% and 4% for the plan years October 1, 2010 and 2009 respectively, the actuarial method is the frozen entry age method and the amortization period is 21.

Monthly contributions are made based on an annual evaluation for the following plan year. The most recently completed Actuarial Report was for the plan year beginning October 1, 2010. The total plan liability for the 2010 plan year was $15,948,500 and the actuarial value of assets $9,203,280 leaving an unfunded liability of $6,745,220 and a funded ratio of 57.71%. The total plan liability for the 2009 plan year was $15,844,265 and the actuarial value of assets $9,180,054 leaving an unfunded liability of $6,664,211 and a funded ratio of 57.94%. The total plan liability for the 2008 year was $15,752,582 and the actuarial value of plan assets was $9,233,359, leaving an unfunded liability of $6,519,223 and a funded ratio of 58.61%.

As of October 1, 2010, the pension benefit obligation is $15,948,500 and was $15,844,265 as of October 1, 2009.

The plan provides for a retirement date, which is the first day of the calendar month, which coincides with, or next follows the employee's 60th birthday, with a minimum of 30 years of service. Early retirement may be taken within ten years of the retirement date. Benefits are determined on credited service, earnings, marital status and choice of options.

The Central Service Association Defined Benefit Plan operates with assistance from Mass Mutual. Mass Mutual holds all of the assets in a wide range of diverse investment funds. Additional information may be obtained from Central Service Association, P.O. Box 3480, 93 South Coley Road, Tupelo, MS 38803-3480.

Effective January 12, 2007, the Department elected to discontinue enrolling new employees in the CSA Pension Plan Program as now, employees will be enrolled with the same retirement plan as the City of Elizabethton, Tennessee with the Tennessee Consolidated Retirement System.

NOTE 6 - RETIREMENT COMMITMENTS (CONTINUED)

The schedule of funding progress, presented as required supplementary information (RSI) following the notes to the financial statements, present multiyear trend information about whether the actuarial values of plan assets are increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	(UAAL) Unfunded AAL	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
10/1/2010	$ 9,203,280	$ 15,948,500	$ 6,745,220	57.71%	$ 2,114,294	319%
10/1/2009	$ 9,180,054	$ 15,844,265	$ 6,664,211	57.94%	$ 2,076,560	321%
10/1/2008	$ 9,233,359	$ 15,752,582	$ 6,519,223	58.61%	$ 2,303,866	283%

The employees of the Department, along with employees of the City of Elizabethton, Tennessee 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 become 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 the system 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 Elizabethton 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, TN 37243-0230 or can be accessed at http://treasury.state.tn.us/tcrs/PS/.

The Department is a fund of the City of Elizabethton, Tennessee and no specific pension benefit obligation can be isolated for the Department. Please refer to the City of Elizabethton, Tennessee as to aggregate funding status, progress, and net assets available for benefits.

NOTE 7 - CAPITAL ASSETS AND DEPRECIATION

	Beginning Balance	Increases	Decreases	Adjustments	Ending Balance
Capital assets, not being depreciated:					
Land	$ 594,194	-	-	-	594,194
Construction in Progress	18,301,304	4,370,937	-	641,553	23,313,794
Total capital assets, not being depreciated	18,895,498	4,370,937	0	641,553	23,907,988
Capital assets, being depreciated:					
Buildings	2,162,687	17,300	-	-	2,179,987
Office Equipment	615,025	20,364	(5)	-	635,384
Transportation Equipment	3,036,022	136,500	(2,498)	(136,500)	3,033,524
Other Machinery and Equipment	1,078,444	33,904	(186)	-	1,112,162
Transmission and Power Distribution System	52,150,786	3,790,641	(758,501)	(106,097)	55,076,829
Total capital assets, being depreciated	59,042,964	3,998,709	(761,190)	(242,597)	62,037,886
Less accumulated depreciation for:					
Buildings	(951,129)	(43,340)	-	-	(994,469)
Office Equipment	(279,833)	(30,952)	5	-	(310,780)
Transportation Equipment	(1,093,666)	(118,711)	2,498	-	(1,209,879)
Other Machinery and Equipment	(572,830)	(72,077)	186	-	(644,721)
Transmission and Power Distribution System	(18,842,106)	(1,571,493)	1,294,070	-	(19,119,529)
Total accumulated depreciation	(21,739,564)	(1,836,573)	1,296,759	0	(22,279,378)
Net Capital Assets being depreciated	37,303,400	2,162,136	535,569	(242,597)	39,758,508
Net Capital Assets	$56,198,898	6,533,073	535,569	398,956	63,666,496

NOTE 8 - LONG-TERM DEBT

The Electric Department issued $3,495,000 of Series 2005 Revenue Refunding Bonds to provide resources that were placed in an irrevocable trust for the purpose of generating resources for the future debt service payments of $3,521,124 on the City's outstanding Series 1997 Department Revenue Bonds. As a result, the refunded bonds of $3,350,000 are considered to be defeased at June 30, 2006. The reacquisition price was more than the net carrying amount of the old debt by $145,000. This amount is being netted against the new debt and amortized over the remaining life of the refunded debt, which is the same as the life of the new debt issued in the basic financials. This advance refunding was undertaken to reduce the total debt service payments over the next seventeen years by $188,399 and resulted in an economic gain of $131,152.

During the June 30, 2008 year, there was a bond issue in the amount of $15,000,000 for improvements to the Department's electric distribution system. The Series 2007 Bonds were issued on December 27, 2007 for twenty years with an interest rate ranging from 4% to 5%. The bonds were issued at a premium. The premium and bond costs are amortized over the life of the bond on the straight line method.

During the June 30, 2010 year, there was another bond issue in the amount of $20,585,000 for additional improvements to the electric distribution and transmission system. The bonds, which are taxable Build America Bonds, mature September 2035 and carry an interest rate ranging from 1.75% to 6.25%. The bonds provide for a 35% federal subsidy on the total interest requirements which is paid semiannually corresponding with the interest payment dates to the bondholders. The interest requirements for this bond in the schedule of maturities are shown at the gross amount. The remaining federal subsidy totals $8,192,351 through the term of the bonds. The bonds were issued at a premium, which along with the bond costs, are being amortized over the life of the bond on the straight-line method. Long-term liability activity for the year ended June 30, 2011 was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Revenue Bonds Payable - 2005	$ 3,100,000	-	(185,000)	2,915,000	190,000
Revenue Bonds Payable - 2007	14,475,000	-	(550,000)	13,925,000	570,000
Revenue Bonds Payable - 2010	20,585,000	-	-	20,585,000	-
Less Deferred Amount On Refunding	(70,563)	-	5,721	(64,842)	-
Add Deferred Amounts for Issuance Premium	445,874	-	(21,286)	424,588	-
Total Bonds Payable	38,535,311	0	(750,565)	37,784,746	760,000
OPEB Liability	205,823	66,130	-	271,953	-
Compensated Absences	879,737	140,107	(744,565)	275,279	111,717
Total Long-term Liabilities	$39,620,871	206,237	(1,495,130)	38,331,978	871,717

NOTE 8 - LONG-TERM DEBT (CONTINUED)

Revenue bonds issued August 24, 2005 debt service requirements to maturity are as follows:

Fiscal Year Ending June 30	Principal	Interest	Total
2012	$ 190,000	112,733	302,733
2013	200,000	105,170	305,170
2014	205,000	97,070	302,070
2015	215,000	88,670	303,670
2016	225,000	79,870	304,870
2017-2021	1,285,000	255,852	1,540,852
2022-2023	595,000	24,723	619,723
	$ 2,915,000	764,088	3,679,088

The bonds are secured by a pledge of the net revenues of the Department. Neither the full faith and credit nor taxing power of the City of Elizabethton is pledged.

Revenue bonds issued December 27, 2007 debt service requirements to maturity are as fol

Fiscal Year Ending June 30	Principal	Interest	Total
2012	$ 570,000	595,200	1,165,200
2013	595,000	571,900	1,166,900
2014	620,000	547,600	1,167,600
2015	645,000	519,075	1,164,075
2016	675,000	486,075	1,161,075
2017-2021	3,855,000	1,940,950	5,795,950
2022-2026	4,745,000	1,046,963	5,791,963
2027-2028	2,220,000	101,025	2,321,025
	$13,925,000	5,808,788	19,733,788

The bonds are secured by a pledge of the net revenues of the Department subject to the prior lien of the outstanding revenue refunding bonds (2005 issue). Neither the full faith and credit nor taxing power of the City of Elizabethton is pledged

NOTE 8 - LONG-TERM DEBT (CONTINUED)

Revenue bonds issued April 20, 2010 debt service requirements to maturity are as follows:

Fiscal Year Ending June 30	Principal	Interest	Total
2012	$ -	1,185,844	1,185,844
2013	130,000	1,184,706	1,314,706
2014	135,000	1,181,965	1,316,965
2015	140,000	1,178,350	1,318,350
2016	145,000	1,173,981	1,318,981
2017-2021	775,000	5,780,988	6,555,988
2022-2026	1,880,000	5,507,547	7,387,547
2027-2031	6,630,000	4,490,422	11,120,422
2032-2036	10,750,000	1,722,919	12,472,919
	$20,585,000	23,406,722	43,991,722

The full faith and credit of the City of Elizabethton, Tennessee is pledged. The bonds are also payable from and are secured by a pledge of the Net Revenues to be derived from the operation of the Electric Distribution System, subject to prior pledges of net revenues in favor of prior lien obligations. The bonds are additionally payable from, but not secured by, direct payment credits received in respect of such emission of bonds.

Total debt service requirements to maturity for revenue bonds are as follows:

Fiscal Year Ending June 30	Principal	Interest	Total
2012	$ 760,000	1,893,777	2,653,777
2013	925,000	1,861,776	2,786,776
2014	960,000	1,826,635	2,786,635
2015	1,000,000	1,786,095	2,786,095
2016	1,045,000	1,739,926	2,784,926
2017-2021	5,915,000	7,977,790	13,892,790
2022-2026	7,220,000	6,579,233	13,799,233
2027-2031	8,850,000	4,591,447	13,441,447
2032-2036	10,750,000	1,722,919	12,472,919
	$ 37,425,000	29,979,598	67,404,598

NOTE 9 - INTERFUND ACTIVITY

As described in Note 1, the Department is a self-supporting fund of the City of Elizabethton, Tennessee (City). In the normal course of operations, the Department provides electrical service to the City at standard electric rates which generated revenues of approximately $916,213 in 2011. As of June 30, 2011, $148,648 was receivable from the City for electrical services. Payment is due within approximately 30 days of the billing. In addition, $154,090 is payable to the City representing in lieu of tax payments. These transactions were consummated on terms equivalent to those that prevail in arm's length transactions.

The Department made tax equivalent payments to the City of $616,286 in 2011. These payments are based on the Department's property, plant and equipment, along with average operating revenues less power costs.

In October 2004, the Department and the City of Elizabethton entered into an agreement where the Department would install a lighting system at the Twins baseball field. The terms of this agreement are for the City to pay the Department monthly payments of $1,337 which includes interest. The interest rate is a fixed interest rate of current prime rate plus 2% (as of July 1 of each year) and shall not exceed 7%. The interest rate as of June 30, 2011 was 5.25%. The period is for 120 months. The total amount at inception was $116,436. At June 30, 2011, the total amount due from the City of Elizabethton is $61,920.

NOTE 10 - OTHER MATTERS

The Department is a member of a cooperative, Central Service Association (CSA), consisting of several utilities in seven states. Normally, excess collections are allocated to the members and repaid in the form of credit memos in the following fiscal year.

Due to a settlement in fiscal year 2003, excess collections were higher than expected; however, the Board of Directors for CSA has projected deficits for future years due to the purchase of a Customer Information Department.

Therefore, special conditions have been adopted by CSA's Board as follows:

- The 2003 allocation will be accounted for separately and reduced as project expenses are recognized.
- Principal repayment of the 2003 allocation will not be required to begin repayment until all project expenses are fully recognized.
- Repayments of the 2003 allocation will be in the form of credit memos.

The Department's share is $15,919. This will be recognized by the Department as it is realized net of project costs.

NOTE 11 - COMMITTMENTS

The Department has active construction projects as of June 30, 2010 for substations and transmission lines. At year-end, the Department's commitments for the projects total approximately $563,000.

NOTE 12 - PRIOR PERIOD ADJUSTMENTS

A prior period adjustment was made to capitalize interest in relation to the cost of borrowing and the fixed assets that the 2005, 2007 and 2010 Revenue Bond funds were used to purchase. The total amount of the adjustment was $528,125.

SECTION II

SUPPLEMENTAL INFORMATION

CITY OF ELIZABETHTON ELECTRIC DEPARTMENT
AN ENTERPRISE FUND OF THE CITY OF ELIZABETHTON, TENNESSEE
SCHEDULE OF FUNDING PROGRESS - UNAUDITED
For the Fiscal Year Ended June 30, 2011

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	(UAAL) Unfunded AAL	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
10/1/2010	$ 9,203,280	$ 15,948,500	$ 6,745,220	57.71%	$ 2,114,294	319%
10/1/2009	$ 9,180,054	$ 15,844,265	$ 6,664,211	57.94%	$ 2,076,560	321%
10/1/2008	$ 9,233,359	$ 15,752,582	$ 6,519,223	58.61%	$ 2,303,866	283%

CITY OF ELIZABETHTON ELECTRIC DEPARTMENT
AN ENTERPRISE FUND OF THE CITY OF ELIZABETHTON, TENNESSEE
SCHEDULE OF FUNDING PROGRESS OF POST RETIREMENT BENEFITS
OTHER THAN PENSIONS - UNAUDITED
For the Fiscal Year Ended June 30, 2011

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	(UAAL) Unfunded AAL	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
7/1/2010	$ -	$ 1,892,996	$ 1,892,996	0.00%	$ 2,412,356	78%
7/1/2009	$ -	$ 2,213,194	$ 2,213,194	0.00%	$ 2,624,138	84%
7/1/2008	$ -	$ 2,212,211	$ 2,212,211	0.00%	$ 2,547,707	87%

CITY OF ELIZABETHTON ELECTRIC DEPARTMENT
AN ENTERPRISE FUND OF THE CITY OF ELIZABETHTON, TENNESSEE
SCHEDULE OF BOND PRINCIPAL AND INTEREST REQUIREMENTS
June 30, 2011

Schedule 1

Fiscal Year Ending	Principal	Interest	Total Requirements
6/30/2012	$ 760,000	1,893,777	2,653,777
6/30/2013	925,000	1,861,776	2,786,776
6/30/2014	960,000	1,826,635	2,786,635
6/30/2015	1,000,000	1,786,095	2,786,095
6/30/2016	1,045,000	1,739,926	2,784,926
6/30/2017	1,090,000	1,691,157	2,781,157
6/30/2018	1,140,000	1,643,651	2,783,651
6/30/2019	1,180,000	1,597,180	2,777,180
6/30/2020	1,230,000	1,548,386	2,778,386
6/30/2021	1,275,000	1,497,416	2,772,416
6/30/2022	1,330,000	1,443,231	2,773,231
6/30/2023	1,385,000	1,385,056	2,770,056
6/30/2024	1,440,000	1,321,154	2,761,154
6/30/2025	1,500,000	1,251,442	2,751,442
6/30/2026	1,565,000	1,178,350	2,743,350
6/30/2027	1,630,000	1,101,419	2,731,419
6/30/2028	1,700,000	1,020,591	2,720,591
6/30/2029	1,770,000	928,275	2,698,275
6/30/2030	1,840,000	824,487	2,664,487
6/30/2031	1,910,000	716,675	2,626,675
6/30/2032	1,985,000	602,212	2,587,212
6/30/2033	2,060,000	480,862	2,540,862
6/30/2034	2,145,000	352,031	2,497,031
6/30/2035	2,235,000	215,157	2,450,157
6/30/2036	2,325,000	72,657	2,397,657
	$ 37,425,000	29,979,598	67,404,598

See independent auditors' report.

CITY OF ELIZABETHTON ELECTRIC DEPARTMENT
AN ENTERPRISE FUND OF THE CITY OF ELIZABETHTON, TENNESSEE
ADDITIONS AND RETIREMENTS TO UTILITY PLANT
June 30, 2011

Schedule 2

	Balance June 30, 2010	Additions	Retirements	Adjustments	Balance June 30, 2011
Land	$ 594,194	-	-	-	594,194
Buildings	2,162,687	17,300	-	-	2,179,987
Office Equipment	615,025	20,364	(5)	-	635,384
Transportation Equipment	3,036,022	136,500	(2,498)	(136,500)	3,033,524
Other Machinery and Equipment	1,078,444	33,904	(186)	-	1,112,162
Transmission and Power Distribution System	52,150,786	3,790,641	(758,501)	(106,097)	55,076,829
Construction in Progress	18,301,304	4,370,937	-	641,553	23,313,794
Totals	$ 77,938,462	8,369,646	(761,190)	398,956	85,945,874

See independent auditors' report.

CITY OF ELIZABETHTON ELECTRIC DEPARTMENT
AN ENTERPRISE FUND OF THE CITY OF ELIZABETHTON, TENNESSEE
SCHEDULE OF INSURANCE
June 30, 2011

Schedule 3

Insurer	Policy Effective	Property Covered	Risk Covered	Limit of Coverage
Tennessee Municipal League	7/1/10	General Liability	Bodily & Personal Injury	
			- Per Person	300,000
			- Per Occurrence	700,000
			Property Damage	100,000
		Property	Building	60,693,726
			($2,500 Deductible)	
			Electronic Data Processing	466,388
			($250 Deductible)	
			Mobile Equipment	2,341,660
			($250 Deductible)	
			Equipment Breakdown	63,035,386
			($2,500 Deductible)	
	7/1/10	Employment	Employee Dishonesty	
		Practices Liability	Per Loss	150,000
			Forgery or Alteration	150,000
			Theft	100,000
			Computer Fraud	100,000
			Errors or Omissions	1,000,000
		Fleet Auto	Bodily Injury	
			Per Person	300,000
			Per Occurrence	700,000
			Property Damage	100,000
			Each Other Loss	1,000,000
			Catastrophic Medical Expenses	1,000,000
			Per Person Medical Payments	1,000
			Per Accident Medical Payments	10,000
			Fire Damage	100,000
			Impounded Property	100,000
			Non-Monetary Defense Costs	100,000
TML Risk Management Pool	7/1/10	Workers'	Bodily Injury	
		Compensation	- Each Accident	300,000
			- Disease (policy limit)	700,000
			- Disease (each employee)	300,000

See independent auditors’ report.

CITY OF ELIZABETHTON ELECTRIC DEPARTMENT
AN ENTERPRISE FUND OF THE CITY OF ELIZABETHTON, TENNESSEE
SCHEDULE OF CURRENT UTILITY RATES AND NUMBER OF CUSTOMERS
June 30, 2011

Schedule 4

Residential Rate Schedule	**RS**	
Customer Charge -		
per delivery point per month		
($9.58 less $1.71 hydro allocation credit)	$11.18	
Energy Charge - per kWh per month	$0.92620	
General Power Rate Schedule	**GSA** (Demand 0-5,000 kW)	**GSB** (Demand 5,000 to 12,000 kW)
Part 1.		
Customer Charge		
Per delivery point per month	$14.46	$1,500.00
Energy Charge - per kWh per month	$0.10324	
Per kWh up to 620 hours per month		$0.94830
Per kWh all additional per month		$0.02771
Demand Charge - per kW per month		$21.03
Excess of billing demand over contract demand - per kW per month		$18.90
Part 2.		
Customer Charge		
Per delivery point per month	$55.00	
Demand Charge - per kW per month		
First 50 kW	$0.00	
Excess over 50kW per month	$12.14	
Energy charge - per kWh per month		
First 15,000 kWh	$0.10302	
Additional kWh per month	$0.06367	
Part 3.		
Customer Charge		
Per delivery point per month	$150.00	
Demand Charge - per kW per month		
First 1,000 kW	$12.73	
Excess over 1,000 kW	$13.97	
Excess of higher of 2,500 kW or contract demand	$0.00	
Energy Charge - per kWh per month		
First 15,000 kWh	$0.06367	
Additional kWh	$0.06367	
Outdoor Lighting Rate Schedule	**LS**	
Customer Charges		
Per delivery point per month	$3.70	
Energy Charge - per kWh	$0.06700	
Number of Customers		
Residential	22,717	
General	3,098	
Street, Athletic and Outdoor Lighting	3,957	
Total Customers	29,772	

See independent auditors' report.

CITY OF ELIZABETHTON ELECTRIC DEPARTMENT
AN ENTERPRISE FUND OF THE CITY OF ELIZABETHTON, TENNESSEE
NET ASSETS BY COMPONENT
Last Nine Fiscal Years

Schedule 5

	Fiscal Year								
	2003	2004	2005	2006	2007	2008	2009	2010	2011
Primary Government									
Invested in Capital Assets, Net of Related Debt	$28,498,564	28,760,803	29,598,525	30,384,839	31,119,505	22,226,537	30,596,682	18,154,567	25,881,750
Unrestricted	1,907,375	2,770,258	3,274,694	5,015,868	6,707,953	17,010,388	9,643,451	22,146,475	16,697,845
Total Primary Government Activities Net Assets	$30,405,939	31,531,061	32,873,219	35,400,707	37,827,458	39,236,925	40,240,133	40,301,042	42,579,595

NOTE: Comparable information was not available for prior years. The Electric Department implemented Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – For State and Local Governments*, during the 2003 fiscal year.

See independent auditors' report.

CITY OF ELIZABETHTON ELECTRIC DEPARTMENT
AN ENTERPRISE FUND OF THE CITY OF ELIZABETHTON, TENNESSEE
CHANGES IN NET ASSETS
Last Nine Fiscal Years

Schedule 6

Fiscal Year	Operating Revenues	Operating Expenses	Operating Income	Total Nonoperating Revenues/ (Expenses)	Income/(Loss) before Transfers	Transfer Out	Change in Net Assets
2003	$ 35,616,463	34,372,515	1,243,948	(160,333)	1,083,615	-	1,083,615
2004	37,031,743	35,115,737	1,916,006	(156,550)	1,759,456	(634,334)	1,125,122
2005	37,603,457	35,463,423	2,140,034	(109,117)	2,030,917	(688,758)	1,342,159
2006	41,633,296	38,327,297	3,305,999	(88,519)	3,217,480	(689,992)	2,527,488
2007	43,901,756	40,976,797	2,924,959	190,965	3,115,924	(689,173)	2,426,751
2008	46,038,644	44,209,051	1,829,593	97,188	1,926,781	(517,314)	1,409,467
2009	52,304,639	50,351,085	1,953,554	(384,558)	1,568,996	(565,788)	1,003,208
2010	49,208,207	47,728,135	1,480,072	(813,667)	666,405	(605,496)	60,909
2011	57,456,596	54,094,513	3,362,083	(995,369)	2,366,714	(616,286)	1,750,428

NOTE: Comparable information was not available for prior years. The Electric Department implemented Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – For State and Local Governments*, during the 2003 fiscal year.

See independent auditors' report.

CITY OF ELIZABETHTON ELECTRIC DEPARTMENT
AN ENTERPRISE FUND OF THE CITY OF ELIZABETHTON, TENNESSEE
OPERATING REVENUE BY SOURCE
Last Nine Fiscal Years

Schedule 7

Fiscal Year	Residential	Large Commercial/ Industrial	Small Lighting/ Power	Street and Outdoor Lighting	Other Operating Revenues	Total
2003	$ 20,868,433	9,532,906	3,514,645	714,906	985,573	35,616,463
2004	21,702,385	9,830,428	3,708,461	731,145	1,059,324	37,031,743
2005	21,946,327	10,215,072	3,476,061	760,913	1,205,084	37,603,457
2006	24,678,822	11,351,765	3,627,682	809,565	1,165,462	41,633,296
2007	26,252,139	11,837,851	3,816,089	825,495	1,170,182	43,901,756
2008	27,653,761	12,366,936	4,123,824	854,016	1,040,107	46,038,644
2009	32,419,144	13,605,402	4,672,946	961,708	645,439	52,304,639
2010	29,833,411	12,261,591	4,412,045	857,402	1,843,758	49,208,207
2011	36,389,623	13,570,064	4,933,634	1,168,494	1,394,781	57,456,596

NOTE: Comparable information was not available for prior years.

See independent auditors’ report.

CITY OF ELIZABETHTON ELECTRIC DEPARTMENT
AN ENTERPRISE FUND OF THE CITY OF ELIZABETHTON, TENNESSEE
OPERATING EXPENSES
Last Nine Fiscal Years

Schedule 8

Fiscal Year	Power Purchased from TVA	Maintenance	Other Operating Expenses	Subtotal, Expenses before Tax and Depreciation	Tax and Tax Equivalents	Provision for Depreciation	Total Operating Expenses
2003	$ 27,092,252	1,462,119	3,459,074	32,013,445	1,048,004	1,311,066	34,372,515
2004	28,422,424	1,475,074	3,517,731	33,415,229	361,924	1,338,584	35,115,737
2005	28,532,987	1,508,146	3,662,089	33,703,222	387,119	1,373,082	35,463,423
2006	31,810,791	1,571,865	3,167,038	36,549,694	357,101	1,420,502	38,327,297
2007	34,022,346	1,657,904	3,461,806	39,142,056	355,702	1,479,039	40,976,797
2008	36,245,964	2,025,280	3,846,817	42,118,061	552,623	1,538,367	44,209,051
2009	42,343,783	2,121,113	3,915,170	48,380,066	389,379	1,581,640	50,351,085
2010	37,956,861	3,374,706	4,288,329	45,619,896	454,772	1,653,467	47,728,135
2011	45,453,172	2,324,997	4,232,685	52,010,854	365,797	1,717,862	54,094,513

NOTE: Comparable information was not available for prior years.

See independent auditors' report.

CITY OF ELIZABETHTON ELECTRIC DEPARTMENT
AN ENTERPRISE FUND OF THE CITY OF ELIZABETHTON, TENNESSEE
NONOPERATING REVENUES AND EXPENSES
Last Nine Fiscal Years

Schedule 9

Fiscal Year	Interest on Invested Funds	Interest Expense	Amortization Expense	Total Nonoperating Revenues and Expenses
2003	$ 47,317	(203,280)	(4,370)	(160,333)
2004	43,109	(195,289)	(4,370)	(156,550)
2005	83,452	(188,199)	(4,370)	(109,117)
2006	146,711	(196,329)	(38,901)	(88,519)
2007	344,645	(148,838)	(4,842)	190,965
2008	472,415	(360,613)	(14,614)	97,188
2009	465,089	(831,566)	(18,081)	(384,558)
2010	108,062	(877,369)	(44,360)	(813,667)
2011	37,346	(995,600)	(37,115)	(995,369)

Note: Comparable information was not available for prior years.

See independent auditors' report.

CITY OF ELIZABETHTON ELECTRIC DEPARTMENT
AN ENTERPRISE FUND OF THE CITY OF ELIZABETHTON, TENNESSEE
RATIO OF OUTSTANDING DEBT BY TYPE (UNAUDITED)
Last Nine Fiscal Years

Schedule 10

			Total		
Fiscal Year	Revenue Bonds	Advance from TVA	Amount	Population	Per Capita
2003	$ 4,095,000	$ 1,804,568	$ 5,899,568	14,017	$ 421
2004	3,890,000	1,531,585	5,421,585	14,017	387
2005	3,765,000	1,315,704	5,080,704	14,017	362
2006	3,780,000	1,216,534	4,996,534	14,017	356
2007	3,620,000	1,253,795	4,873,795	14,017	348
2008	18,455,000	1,221,192	19,676,192	14,017	1,404
2009	18,280,000	1,429,484	19,709,484	14,017	1,406
2010	38,160,000	1,592,086	39,752,086	14,017	2,836
2011	37,425,000	1,569,857	38,994,857	14,176	2,751

* Details regarding the Electric Department's outstanding debt can be found in the notes to the financial statements.

Source: The Population figure comes from the U.S. Census Bureau census of 2010.

NOTE: Comparable information was not available for prior years.

See independent auditors’ report.

CITY OF ELIZABETHTON ELECTRIC DEPARTMENT
AN ENTERPRISE FUND OF THE CITY OF ELIZABETHTON, TENNESSEE
NUMBER OF ELECTRIC CUSTOMERS BY TYPE (UNAUDITED)
Last Nine Fiscal Years

Schedule 11

Fiscal Year	Residential	General *	Street and Outdoor Lighting	Total Customers
2003	21,174	4,044	109	25,327
2004	21,332	3,992	113	25,437
2005	22,157	3,300	117	25,574
2006	22,439	3,230	125	25,794
2007	22,484	3,271	160	25,915
2008	22,504	3,300	159	25,963
2009	22,552	3,290	154	25,996
2010	22,605	3,263	154	26,022
2011	22,717	3,098	172	25,987

NOTE: Comparable information was not available for prior years.

* The General type of Electric Customer includes the Large Commercial and Industrial type and the Small Lighting and Power type. Furthur breakdown of this information was not available.

See independent auditors' report.

CITY OF ELIZABETHTON ELECTRIC DEPARTMENT
AN ENTERPRISE FUND OF THE CITY OF ELIZABETHTON, TENNESSEE
ELECTRICITY RATES (UNAUDITED)
Last Nine Fiscal Years

Schedule 12

	Fiscal Year									
		2003	2004	2005	2006	2007	2008	2009	2010	2011
Residential Rate										
Customer Charge -										
per delivery point per month	$	6.25	7.25	7.25	7.25	7.79	7.87	7.87	7.87	11.18
Energy Charge - per kWh per month		0.05892	0.06231	0.06231	0.07291	0.07096	0.08092	0.07726	0.08329	0.92620
General Power Rate										
Part 1.										
Customer Charge										
Per delivery point per month										
(Demand 0-5,000 kW)	$	12.00	12.40	12.40	13.32	13.32	13.46	13.46	13.46	14.46
(Demand 5,000 to 12,000 kW)		1500	1500	1500	1,500	1,500	1,500	1,500	1,500	1,500
Energy Charge - per kWh per month		0.06596	0.07088	0.07088	0.08289	0.08054	0.09110	0.08782	0.09464	0.10324
Per kWh up to 620 hours per month		0.02825	0.03035	0.03035	0.03588	0.03514	0.04234	0.04592	0.04132	0.94830
Per kWh all additional per month		0.02306	0.02477	0.02477	0.02928	0.02883	0.03559	0.00000	0.03372	0.02771
Demand Charge - per kW per month		10.85	11.58	11.58	13.51	12.95	13.78	13.46	15.40	21.03
Excess of billing demand over										
contract demand - per kW per month		10.85	11.58	11.58	13.51	12.95	13.78	14.21	14.89	18.90
Part 2.										
Customer Charge										
Per delivery point per month	$	30.00	31.00	31.00	33.30	33.30	33.64	33.64	33.64	55.00
Demand Charge - per kW per month										
First 50 kW		0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Excess over 50kW per month		9.71	10.44	10.44	12.08	11.65	12.43	12.77	13.70	12.14
Energy charge - per kWh per month										
First 15,000 kWh		0.06596	0.07088	0.07088	0.08289	0.08054	0.09110	0.08782	0.09464	0.10302
Additional kWh per month		0.03377	0.03649	0.03649	0.04320	0.04224	0.05021	0.04592	0.04975	0.06367
Part 3.										
Customer Charge										
Per delivery point per month	$	80.00	82.60	82.60	88.73	88.73	89.63	89.63	89.63	150.00
Demand Charge - per kW per month										
First 1,000 kW		9.48	10.16	10.16	11.87	11.41	12.23	12.59	13.57	12.73
Excess over 1,000 kW		10.20	11.25	11.25	13.28	12.74	13.70	14.12	15.27	13.97
Excess of higher of 2,500 kW or										
contract demand		10.20	11.25	11.25	0.00	0.00	0.00	0.00	0.00	0.00
Energy Charge - per kWh per month										
First 15,000 kWh		0.06434	0.06741	0.06741	0.07450	0.07354	0.08183	0.08592	0.08137	0.06367
Additional kWh		0.03377	0.03649	0.03649	0.04320	0.04224	0.05021	0.05430	0.04975	0.06367
Outdoor Lighting Rate Schedule										
Customer Charges										
Per delivery point per month	$	2.50	2.50	2.50	2.50	2.50	3.75	3.75	3.75	3.70
Energy Charge - per kWh		0.04375	0.04616	0.04616	0.05257	0.05159	0.05935	0.05493	0.05889	0.06700

NOTE: Comparable information was not available for prior years.

See independent auditors' report.

SECTION III

INTERNAL CONTROL AND COMPLIANCE SECTION

Blackburn, Childers & Steagall, PLC

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS
AMERICAN INSTITUTE OF CERTIFED PUBLIC ACCOUNTANTS

1961 50 YEARS 2011

CELEBRATING OUR 50TH ANNIVERSARY

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*

Honorable Mayor, City Council Members
and City Manager
City of Elizabethton Electric Department
Elizabethton, Tennessee 37643

We have audited the financial statements of the City of Elizabethton Electric Department (the "Department") (an enterprise fund of the City of Elizabethton, Tennessee) as of and for the year ended June 30, 2011, and have issued our report thereon dated December 6, 2011. The independent auditors' report contained an explanatory paragraph stating that the report of the Department does not purport to present the financial position and changes in financial position and cash flows of the City of Elizabethton, Tennessee. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Department's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and responses to be material weaknesses: 2010-01 and 2010-02.

Johnson City	801B Sunset Drive, Johnson City, TN 37604	(423) 282-4511	Fax (423) 283-4532
Kingsport	440 E. Sullivan Street, Kingsport, TN 37660	(423) 246-1725	Fax (423) 247-6800
Greeneville	550 Tusculum Boulevard, Greeneville, TN 37745	(423) 638-8516	Fax (423) 638-3361

website: http://www.BCScpa.com e-mail: BCS@BCScpa.com

A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying schedule of findings and responses to be significant deficiencies. These include 2011-01, 2011-02, 2010-01, 2010-02, 2010-04, and 2007-03.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. These include 2011-01, 2011-02, 2010-01, 2010-02, 2010-04, and 2007-03.

We noted certain other matters that we reported to management of City of Elizabethton Electric Department in a separate letter dated December 6, 2011.

The Department's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the Department's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the City Council and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

Blackburn, Childers + Steagall, PLC
BLACKBURN, CHILDERS & STEAGALL, PLC

December 6, 2011

CURRENT YEAR FINDINGS

2011-01: Significant Deficiency: Bank Reconciliations

Condition: It appears that monthly bank reconciliations are lacking proper and timely approval. It was also noted that the bank reconciliation form did not contain all reconciling items needed in order to agree the general leger to the ending bank balance.

Criteria: To enhance internal controls and to increase proper oversight and independent review, all monthly bank reconciliations should appropriately documented all reconciling items needed to agree the general ledger to the bank balance and should be properly and timely approved. The *Internal Control and Compliance Manual for Tennessee Municipalities* (Manual) issued by the Tennessee Comptroller in Title 5, Chapter 1, Section 9 indicates that municipal officials should ensure that bank statements are reconciled with the cash balances presented in the accounting records. Bank reconciliations should be prepared within 30 days after the bank statements are received from the bank. In addition, the Manual indicates in Title 6, Chapter 1 that municipal officials should provide constant, close supervision to ensure that bank accounts and control accounts in the municipality's accounting records are being reconciled systematically and the reconciliation is documented and retained.

Effect: The effect of this weakness creates the possibility that misstatements may not be timely noted or corrected.

Recommendation: We recommend that monthly bank reconciliations show in detail how the general ledger agrees to the ending bank balance each month. These reconciliations should be properly documented and approved.

Management's Response: Bank reconciliations will be reviewed timely by the Finance Director and/or the Deputy Finance Director. Reconciliations will be in similar form and include documentation as presented in the general fund.

2011-02: Significant Deficiency: Software Conversion Billing Adjustments

Condition: It was noted that an independent computer and data consultant, under contract with the Department to assist with the data conversion to the new Incode system, also assisted the customer service department with billing issues and other customer account issues caused by the conversion. There is no evidence that any adjustments made to the system, or customer account setups, by this consultant have been reviewed or approved.

Criteria: To enhance internal controls and to increase proper oversight and independent review, all adjustments should be appropriately documented and approved.

CURRENT YEAR FINDINGS (Continued)

Effect: The effect of this weakness creates the possibility that misstatements may not be timely noted or corrected**.**

Recommendation: We recommend that Council approve a new contract with this independent consultant that specifically states the types of adjustments this individual is approved to make. We also recommend that all adjustments posted by the consultant be appropriately documented and approved.

Management's Response: Independent consultants will not have the authority to make adjustments except under the direct documented supervision of an authorized City employee. The Electric Department is currently revising the standard procedure manual formally identified as SAS 70 to outline necessary requirements for any adjustments to customer accounts.

PRIOR YEAR FINDINGS NOT IMPLEMENTED

2010-01: Material Weakness: Journal Entries (Repeated from 6/30/10 Report)

Condition: It appears that journal entries are lacking proper and timely approval before they are posted to the system. There also appears to be lack of supporting documentation for all posted journal entries.

Criteria: To enhance internal controls and to increase proper oversight and independent review, all adjustments and transfers should be appropriately documented and approved. The *Internal Control and Compliance Manual for Tennessee Municipalities* (Manual) issued by the Tennessee Comptroller indicates in Title 2, Chapter 2 that municipal officials should ensure that a management level employee periodically review journal entries to determine that they are approved.

Effect: The effect of this weakness creates the possibility that misstatements may not be timely noted or corrected.

Recommendation: We recommend a procedure be in place for the timely review and approval of all journal entries. Someone other than the preparer should review these items. We suggest that a monthly listing of all entries posted be maintained.

Management's Response: All journal entries will be logged in the same manner that the City's General Fund has been in the past. Supporting documentation will be filed with all journal entries. The Finance Director and/or the Deputy Finance Director will review and approve journal entries.

PRIOR YEAR FINDINGS NOT IMPLEMENTED (Continued)

2010-02: Material Weakness: Adjustments (Repeated from 6/30/10 Report, with additional current year items noted)

Condition: Under current professional standards, the Department is responsible for the internal control process which includes the preparation of year-end financial statements in accordance with generally accepted accounting principles and the accrual basis of accounting. Audit adjustments were necessary to properly state account balances including: investments, capitalized interest, accounts payable, and compensated absences

***Criteria*:** General ledger accounts should be timely reviewed, reconciled to the appropriate supporting documentation or subsidiary ledger reports and adjusted. The Manual indicates in Title 6, Chapter 1 that municipal officials should provide constant, close supervision to ensure that:

- Internal controls are working
- Personnel are following the prescribed routines
- Bank accounts and control accounts in the municipality's accounting records are being reconciled systematically and the reconciliation is documented and retained.

Municipal officials should require internal control procedures that help prevent and/or detect errors and irregularities. These procedures include designating an employee without prior access to the records to: reconcile subsidiary ledgers detailing receivables, deposits, etc., with general ledger totals.

Effect: The effect of this deficiency creates the possibility that misstatements may not be timely noted or corrected.

Recommendation: We recommend a procedure be in place to prepare routine, monthly and year-end reconciliations for general ledger accounts to the supporting documentation and subsidiary ledgers and to make related adjustments. The procedure should require retention of supporting documentation for all entries and transfers, including indication of appropriate review and approval. These routine reconciliations and adjustments will ensure meaningful and accurate financial statements. Reconciliation of Statement of Net Assets and other significant accounts quickly identify errors and needed corrections. If reconciliations are performed infrequently, errors and adjustments can occur, resulting in the need for significant corrections when the reconciliations are performed. Any reconciling differences should be corrected before the books are closed for the month end.

Management's Response: Management recognizes its responsibility to review and reconcile relevant account balances so as to reduce and eliminate audit adjustments. Checklists created for the general fund for yearend closings will be applied to the electric department to help prevent and/or detect errors and irregularities.

PRIOR YEAR FINDINGS NOT IMPLEMENTED (Continued)

2010-04: Significant Deficiency: Cash Flow Concerns (Repeated from 6/30/10 Report, with additional current year items noted)

***Condition*:** While net income increased from prior year by approximately $1,690,000, cash flow issues continue to remain a concern. With the substantial drop in certificates of deposit and investments at yearend with additional decrease subsequent to yearend, the Department's ability to finance operations during another major storm is questionable. The Department also continues to be involved in several large projects that are requiring a considerable amount of the Department's funds.

***Criteria*:** State statues require electric operations to have a rate structure sufficient to cover expenses. Enterprise funds should be self-supporting and cash balances should be adequate to properly cover expenses.

Effect: The effect of this deficiency creates overall concern for cash management.

Recommendation*:* Revenues and expenses should be reviewed to provide adequate income for the Department. Monthly budgets and financial reports should be prepared and reviewed. Municipal officials should ensure cash reserves are in place in order to meet obligations. The Government Finance Officers Association (GFOA) has issued as a "Best Practice" a summary memorandum titled, Appropriate Levels of Working Capital in Enterprise Funds. Within this best practice, the GFOA recommends that local governments adopt a target amount of working capital to maintain in each of their enterprise funds. GFOA recommends that governments develop a target that best fits local conditions for each fund. However, GFOA recommends that under no circumstances should the target for working capital be less than 45 days worth of annual operating expenses. The memorandum also discusses several items to consider including "cash cycles", demand for services and controls over rates and revenues. The best practice can be obtained from the GFOA's website.

Management's Response: We have scheduled a City Council workshop for October 25, 2011 to discuss a possible rate increase to alleviate long term concerns with cash. We have also started the application process for a letter of credit to address short term cash flow concerns.

PRIOR YEAR FINDINGS NOT IMPLEMENTED (Continued)

2007-03: Significant Deficiency: Work Orders (Repeated from 6-30-07 Report, with additional current year items noted)

***Condition*:** Proper work order procedures and controls were not always followed. In some instances, materials and contracted labor were entered as both a purchase order and a payable. This required the reversal of those amounts that were entered twice. It appears that engineering did not always properly describe any aid to construction information on the work order. Several instances were noted of major work orders not being properly and timely closed. It was also noted that the Department did not maintain the proper supporting documentation for changes to work orders during the year. It was noted that there was a lack of proper documentation and/or support for the "retirements" made during the year mainly due to the Departments decision to discontinue the use current work order management system. Some detail was available, but the support did not document dollar values, therefore none of the support could be traced back into the general ledger.

***Criteria*:** Proper work order procedures should be followed to document all aspects of the work order to enhance internal controls over the financial reporting process. These should be routinely reviewed for the status of the job and necessary adjustments should be documented and posted to close or transfer completed projects. The Department should account for work orders using a work order management system, on a continuous basis, that has the ability to post all transactions into the general ledger and generate reports that detail all aspects of each work order.

Effect: The effect of this deficiency results in a weakness in proper controls over financial reporting. The lack of a work order management system for the allocation of costs for open jobs (materials, stores expense, transportation, direct labor (hours and cost), direct cost and aid to construction, indirect labor, and contract labor), and the process of properly closing jobs opens the Department to substantial risk of misstatements, errors, and or fraudulent reporting.

***Recommendation**:* We recommend that all work order documentation be completed in full detail and work orders be reviewed and properly approved. Since an accurate work order system is the backbone of a utility district's operations, we also suggest the Department select and implement a new system as soon as possible.

Management's Response: In our current software conversion we are specifically addressing work order documentation, timing, flow and coordination through the various individuals needed to complete the process. In as much as the work order portion has not been implemented it is impossible to describe the specific remedies to individual concerns. However the City, in the conversion process, is using the audit finding as the standard for successful implementation.

PRIOR YEAR FINDINGS IMPLEMENTED

2010-03: Supporting Documentation – Bond Funds

2010-05: Authorizations of Investment Fund Transfers

2010-06: Disbursements