CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

FINANCIAL STATEMENTS

SEPTEMBER 30, 2006 AND 2005

C O N T E N T S

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Carter, Belcourt & Atkinson, P.A.
CERTIFIED PUBLIC ACCOUNTANTS AND BUSINESS ADVISORS

INDEPENDENT AUDITORS' REPORT

Honorable Mayor, City Commissioners
and City Manager
City of Lakeland, Florida

We have audited the accompanying financial statements of the Department of Electric Utilities of the City of Lakeland, Florida, as of September 30, 2006 and 2005, as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 A, the financial statements present only the Department of Electric Utilities of the City of Lakeland, Florida, and do not purport to, and do not, present fairly the financial position of the City of Lakeland, Florida, as of September 30, 2006 and 2005, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Department of Electric Utilities of the City of Lakeland, Florida, as of September 30, 2006 and 2005, and the changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note B, in previous years the net pension obligation calculation has incorrectly included the employees' annual required contribution and actual contributions instead of just the employer's contributions. Accordingly the Department of Electric Utilities of the City of Lakeland, FL has restated the 2005 financial statements to correct these errors.

The *Management's Discussion and Analysis* on pages 3 through 7 is not a required part of the basic financial statements but is supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Carter, Belcourt + Atkinson, P.A.

February 20, 2007
Lakeland, Florida

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

Management's Discussion and Analysis

The Management's Discussion and Analysis section provides a narrative overview of the City of Lakeland's Department of Electric Utilities' (Lakeland Electric) financial activities for the fiscal year ending September 30, 2006. Readers are encouraged to consider the information presented in this section in conjunction with additional information contained in the financial report. The following condensed Balance Sheet and Statement of Revenues, Expenses and Changes in Net Assets summarizes the financial condition and operations of Lakeland Electric for the years ended September 30, 2006 and 2005 respectively:

	(In Thousands)	
	September 30	
	2006	2005
Assets		
Utility plant, net	$ 605,533	$ 622,200
Current assets	171,888	137,549
Noncurrent assets	106,412	103,496
	$ 883,833	$ 863,245
Liabilities and Net Assets		
Current liabilities	$ 90,517	$ 91,740
Noncurrent liabilities	534,196	497,985
Net assets invested in capital assets, net of related debt	134,123	156,244
Unrestricted net assets	124,997	117,276
	$ 883,833	$ 863,245
Revenues, Expenses and Changes in Net Assets		
OPERATING REVENUES		
Sales of energy - retail	$ 332,167	$ 287,753
Sales of energy and capacity sales - wholesale	39,440	42,333
Other electric operating revene	5,440	6,134
	377,047	336,220
OPERATING EXPENSES		
Fuel and purchased power	245,649	200,563
Energy supply	21,145	22,279
Energy delivery	16,634	16,144
Customer service and accounting	7,726	7,408
Administrative and general	14,264	14,155
State tax on electric sales	8,342	7,327
Depreciation	38,712	37,502
	352,472	305,378
OPERATING INCOME	24,575	30,842
NON-OPERATING ACTIVITY		
Investment and other income	4,919	1,917
Interest and amortization	(25,785)	(25,815)
Transfers to other funds	(18,109)	(17,366)
	(38,975)	(41,264)
CHANGE IN NET ASSETS	$ (14,400)	$ (10,422)

Financial Highlights

- Operating revenues for the fiscal year 2006 were $377 million, which was an increase of $40.8 million from the previous fiscal year. The non-fuel component of retail revenues increased by approximately $8 million from 2005 to 2006 as the total retail sales volume increased by 4.4 percent. There was an overall increase of 2.1 percent in the customer base from the previous fiscal year. The residential sector of the market grew at a faster rate than the commercial and industrial sector. Given that residential rates are higher than rates for the commercial and industrial sector this pattern resulted in a higher average retail revenue per Kwh for the year.

- Lakeland Electric's non-fuel operating costs (excluding fuel, gross receipts tax, and depreciation) were $59.8 million in fiscal year 2006, a slight decrease from $60.0 million in the previous fiscal year. There was a slight reduction in the total workforce during fiscal year 2006 following more significant decreases in the previous two fiscal years. Operating and maintenance costs fell to an average of $20.52 per megawatt hour (Mwh) of energy in 2006 from $21.48 in 2005.

- The net profitability of retail operations (measured before transfers) increased from $22.6 million for fiscal 2005 to $31.0 million for fiscal 2006.

- The net loss from wholesale operations increased from $15.7 million in fiscal 2005 to $27.3 million for fiscal 2006 as a result of increased losses associated with an unfavorable wholesale power contract (see Economic Factors).

- Fuel and purchased power expenses increased by $45 million, or 22.5 percent from the previous fiscal year. The average cost of fuel to generate a Mwh of energy to serve the retail load increased from $51.58 in fiscal year 2005 to $61.81 in fiscal year 2006. This is due primarily to an increase in the average hedged price of natural gas from approximately $8 per mmbtu in fiscal 2005 to over $10 in fiscal 2006. The electric utility recovers 100 percent of fuel costs from retail customers in the form of a fuel charge that is revised quarterly as needed based on a forecast of fuel costs for the following 12 months.

- Deferred Regulatory Charges of $7.7 million are included in Lakeland Electric's current assets. This represents a receivable from retail customers for the cumulative difference between fuel costs incurred to serve retail load and fuel revenues realized. This amount represents a decrease of $4.4 million compared to the preceding year. For fiscal year 2006, the average fuel charge recovered from retail customers was $63.50 per Mwh.

- Lakeland Electric issued Series 2006 and Series 2006A variable rate refunding and revenue bonds during the fiscal year having a combined par value of $184 million for the purpose of financing certain capital improvements and to refund, on a current basis, approximately $148 million of variable rate energy system revenue bonds Series 2001A and Series 2003 and a portion of Series 1999B energy system revenue bonds.

- Capital spending for the 2006 fiscal year totaled approximately $21.3 million compared to $24.6 million in 2005 and $25.7 million in 2004. Lakeland Electric has identified $90 million of EPA compliance and customer growth related capital improvements that will be financed from the proceeds of two bond issues; one issue sold in August 2006 and the second planned for August 2007.

- Lakeland Electric provides a dividend to the General Fund each year in the form of a cash transfer. The total amount of this dividend for fiscal year 2006 was $18 million, which amounted to 4.8 percent of gross operating revenues of Lakeland Electric. This dividend level is substantially below the industry median of 6.3 percent (as reported by the APPA). The reduced dividend level for both 2005 and 2006 is intended to offset a portion of the losses incurred in conjunction with an unfavorable wholesale power contract (see Economic Factors).

- For the fiscal year, the utility realized a net increase in net current assets and net designated assets from $131.9 million at the end of fiscal 2005 to $139.6 million at the end of fiscal 2006.

Financial Highlights (Continued)

Capital Assets

The following table contains a summary of Lakeland Electric plant investment net of accumulated depreciation as of the September 30, 2006 and 2005:

	(In Thousands) September 30 2006	2005
Land	$ 15,197	$ 15,254
Construction in process	20,772	20,385
Buildings	20,048	20,916
Machinery and equipment	18,643	20,641
Electric transmission and distribution	218,063	216,143
Electric plants in service	312,810	328,861
	$ 605,533	$ 622,200

The generating capacity of the production units owned by the City is 984 megawatts (MW). The most cost effective unit in the generating fleet is the 365 MW McIntosh 3 coal unit, of which 60 percent or 218 MW is owned by Lakeland Electric. During the past five years, Lakeland Electric has placed a 350 MW combined cycle natural gas unit and a 50 MW internal combustion peaking facility into service. Lakeland Electric has sufficient generation and transmission capacity to cover its projected load requirements for at least the next five years.

As can be seen in the above schedule, there was a net decrease in fixed assets during fiscal year 2006 as depreciation and retirements exceeded additions. Management is now concentrating on long term capital improvement issues such as the replacement of older generation units and enhancements to the electric delivery system.

Debt

At September 30, 2006, Lakeland Electric had $504.8 million in net long-term debt outstanding compared to $471.4 million at the end of 2005 as shown in the following table:

	(In Thousands) September 30 2006	2005
Electric System Revenue Bonds:		
Series 1999A	$ 193,230	$ 193,785
Series 1999B	51,185	81,310
Series 1999C	64,525	64,525
Series 2001A	-	90,000
Series 2001B	30,000	30,000
Series 2003	-	47,860
Series 2006	44,870	-
Series 2006A	139,475	-
	523,285	507,480
Less current portion	(575)	(15,095)
Less unamortized loss on refunding	(20,173)	(22,148)
Unamortized bond discount (net of premium)	2,302	1,153
	$ 504,839	$ 471,390

Debt (continued)

As indicated in the preceding table, Lakeland Electric issued Series 2006 and Series 2006A variable rate refunding and revenue bonds during the fiscal year with a combined par value of $184.3 million. In addition to financing certain capital improvements, the 2006 issues refunded the variable rate energy system revenue bonds Series 2001A and Series 2003, as well as a portion of the Series 1999B energy system revenue bonds.

Included in the debt portfolio is $139.5 million of variable rate debt that has been converted to fixed rates using a variety of swap transactions as a hedge.

Bonds outstanding carry an average life of 15.2 years and the average interest rate on the portfolio is approximately 4.4 percent.

Economic Factors

As indicated in Note O, coverage on bonded debt of Lakeland Electric remains very strong at 4.01 times the annual debt service requirement for the fiscal year ended 2006. Per the enabling bond ordinance, an amount equal to 20 percent of the fund balance of Lakeland Electric is included as a component of net revenues in preparing this calculation. This coverage calculation also includes the impact of a current refunding of approximately $16.1 million of principal and interest maturing on October 1, 2006. Removing these latter aspects of the coverage calculation yields a coverage ratio of 1.74 compared to a similarly calculate coverage ration of 1.87 for fiscal year 2005.

In December 2000 Lakeland Electric entered into a contract with the Florida Municipal Power Association (FMPA) that allows FMPA the option of taking up to 100 MW of energy per hour at a fixed price. The contract contains a fuel escalation clause that has not kept pace with the rapid increase in natural gas prices, creating significant losses to Lakeland Electric. During fiscal year 2006 the FMPA purchased 655,000 megawatt-hours (MWH) under the contract which was just slightly less than the 655,200 MWH purchased in FY 2005. The total loss on the contract for the fiscal year 2006 was $30.5 million, which is up substantially compared to the fiscal year 2005 loss of $18.4 million. The increased loss resulted from substantially higher natural gas costs during much of the fiscal year.

Lakeland Electric has utilized a variety of strategies to mitigate the impact of the FMPA losses. The $18 million dividend paid to the City's General Fund from Lakeland Electric was less than originally intended. The utility continued its' ongoing efforts to control costs, resulting in lower overall operating and maintenance costs as well as lower costs per Mwh. The utility entered into a current refunding of debt maturing on October 1, 2006 in the amount of $10 million, which lowered the amount of debt maturities financed from rate revenues for the year to $6.1 million. As a result of these mitigating strategies, the utility realized an increase in the combined dollar value of net current assets and net designated assets in the amount of $7.7 million for the 2006 fiscal year.

During fiscal year 2004 Lakeland Electric negotiated with FMPA to shorten the length of the contract by three years from December 2010 to December 2007. Lakeland Electric currently has hedged 87 percent of the estimated natural gas required to service the remainder of that contract at an average price of $8.14 per mmbtu. Future losses from the FMPA contract thru the contract's expiration date are estimated to be approximately $28 million. It is anticipated that these losses will be absorbed by the utility with little or no impact on operating reserves.

Significant natural gas and oil price fluctuations have occurred in recent years; and in an effort to control the risk associated with fuel price volatility, Lakeland Electric has created a fuel hedging program that is intended to spread the short-term impact of price volatility over a longer period of time. The program has historically allowed for the purchase of natural gas using financial and physical contract for a period of up to 12 months in the future. During fiscal 2006, this program was expanded to provide for hedging of natural gas prices up to 30 months in advance.

Using This Annual Report

This annual report includes the balance sheet, statement of revenues, expenses and change in net assets, statement of cash flows and notes to the financial statements for Lakeland Electric, which is an enterprise fund of the City of Lakeland. Please refer to the annual report of the City of Lakeland for more information about the City of Lakeland as a whole.

Requests for Information

This financial report is designed to provide a general overview of Lakeland Electric's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to: Assistant Finance Director - Electric, Lakeland Electric, 501 East Lemon St, Lakeland, FL 33801.

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

BALANCE SHEETS

	September 30 2006	September 30 2005
ASSETS		
UTILITY PLANT		
Utility plant in service	$ 1,050,765,348	$ 1,035,405,274
Less accumulated depreciation	466,003,716	433,590,422
	584,761,632	601,814,852
Construction in progress	20,771,784	20,385,220
Total utility plant, net	605,533,416	622,200,072
CURRENT ASSETS		
Cash and cash equivalents	20,755,524	16,817,168
Investments	2,683	2,683
Accounts receivable	56,627,544	51,403,731
Less allowance for uncollectibles	(1,208,002)	(805,816)
Inventories	30,268,188	25,780,858
Deferred regulatory charges	7,737,949	12,167,670
Designated assets (current portion)	12,783,925	28,074,648
Other current assets	44,920,258	4,107,803
Total current assets	171,888,069	137,548,745
NONCURRENT ASSETS		
Restricted assets	37,998,887	9,110,765
Designated assets	58,209,194	86,073,058
Other assets	10,203,072	8,312,181
Total noncurrent assets	106,411,153	103,496,004
TOTALS	$ 883,832,638	$ 863,244,821
LIABILITIES		
CURRENT LIABILITIES, payable from current assets		
Accounts payable	$ 32,565,773	$ 40,722,505
Accrued liabilities	4,035,232	3,065,192
Due to other funds	41,131,508	137,473
Deferred revenue	-	19,740,363
Current liabilities payable from designated assets	12,783,925	28,074,648
Total current liabilities, payable from current assets	90,516,438	91,740,181
NONCURRENT LIABILITIES		
Long-term debt, less current portion	504,838,655	471,389,624
Accrued liabilities, less current portion	18,981,809	16,659,495
Advances from other funds, less current portion	687,365	824,838
Restricted liabilities	9,688,249	9,110,765
Total noncurrent liabilities	534,196,078	497,984,722
Total liabilities	624,712,516	589,724,903
NET ASSETS		
Invested in capital assets, net of related debt	134,123,306	156,243,717
Unrestricted	124,996,816	117,276,201
Total net assets	259,120,122	273,519,918
TOTALS	$ 883,832,638	$ 863,244,821

See accompanying notes to financial statements

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	Year ended September 30 2006	2005
OPERATING REVENUES		
Sales of energy - retail	$ 332,168,035	$ 287,753,273
Sales of energy and capacity sales - wholesale	39,439,857	42,333,082
Other electric operating revenue	5,439,509	6,133,805
Total operating revenues	377,047,401	336,220,160
OPERATING EXPENSES		
Fuel and purchased power	245,648,555	200,563,029
Energy supply	21,144,815	22,279,382
Energy delivery	16,634,636	16,143,654
Customer service	7,726,693	7,407,528
State tax on electric sales	8,341,868	7,326,656
Administrative and general	14,263,781	14,154,669
Total operating expenses	313,760,348	267,874,918
OPERATING INCOME BEFORE DEPRECIATION	63,287,053	68,345,242
Less depreciation	38,712,207	37,502,433
OPERATING INCOME	24,574,846	30,842,809
NONOPERATING REVENUES (EXPENSES)		
Investment revenue (less $142,441 capitalized in 2006)	2,707,143	2,632,729
Net increase (decrease) in the fair value of cash equivalents	1,016,505	(1,204,790)
Miscelleous revenue	1,195,079	488,815
Interest expense and fiscal charges (less $453,631 and $539,433 capitalized in 2006 and 2005, respectively)	(23,292,244)	(23,333,039)
Amortization expense	(2,492,478)	(2,482,058)
	(20,865,995)	(23,898,343)
INCOME BEFORE TRANSFERS	3,708,851	6,944,466
TRANSFERS TO OTHER FUNDS	(18,140,000)	(17,365,987)
TRANSFERS FROM OTHER FUNDS	31,353	-
CHANGE IN NET ASSETS	(14,399,796)	(10,421,521)
NET ASSETS, restated, Note B	273,519,918	283,941,439
NET ASSETS, end of year	$ 259,120,122	$ 273,519,918

See accompanying notes to financial statements

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

STATEMENTS OF CASH FLOWS

	Year ended September 30	
	2006	2005
Cash flows from operating activities:		
Receipts from customers	$ 353,074,306	$ 344,415,706
Payments for interfund services	(8,290,354)	(8,290,354)
Payments to suppliers	(324,125,402)	(223,542,833)
Payments to employees	(26,533,144)	(28,783,802)
Net cash provided by (used in) operating activities	(5,874,594)	83,798,717
Cash flows from noncapital financing activities:		
Increase in meter deposits payable, net	516,946	1,472,831
Operating transfers to other funds	(18,140,000)	(16,423,894)
Cash flows used in noncapital financing activities	(17,623,054)	(14,951,063)
Cash flows from capital financing activities:		
Interest paid on long-term debt issued to finance capital assets	(25,252,479)	(23,380,252)
Proceeds from issuance of long-term debt	184,345,000	-
Net issuance (repayment) of interfund loans	40,881,697	(117,337)
Payments on and maturities of long-term debt	(168,540,000)	(13,250,000)
Purchase of capital assets	(20,761,287)	(21,772,916)
Cash flows provided by (used in) capital financing activities:	10,672,931	(58,520,505)
Cash flows from investing activities:		
Investment revenue	2,849,584	2,632,729
Net increase (decrease) in the fair value of cash equivalents	1,016,505	(1,205,522)
Cash flows provided by investing activities	3,866,089	1,427,207
Net increase (decrease) in cash and cash equivalents	(8,958,628)	11,754,356
Cash and cash equivalents, beginning of year	124,081,858	112,327,502
Cash and cash equivalents, end of year	$ 115,123,230	$ 124,081,858
Adjustments to reconcile operating income to net cash provided by operating activities:		
Operating income	$ 24,574,846	$ 30,842,809
Depreciation	38,712,207	37,502,433
Miscellaneous revenue	1,195,079	488,815
Increase in receivables, net	(5,427,811)	(7,084,199)
Increase in inventory	(4,487,331)	(2,265,289)
Increase in other current assets	(40,812,455)	(3,380,991)
Decrease (increase) in deferred regulatory charges	4,429,721	(6,132,649)
Decrease (increase) in net pension obligation	(12,906)	(597,024)
Increase (decrease) in accounts payable	(8,156,732)	17,885,347
Increase in accrued liabilities	3,292,354	1,612,304
Increase (decrease) in deferred revenue	(19,740,363)	14,790,930
Increase in deposits	558,797	136,231
Net cash provided by (used in) operating activities	$ (5,874,594)	$ 83,798,717

See accompanying notes to financial statements

NOTES TO FINANCIAL STATEMENTS

NOTE A -SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These financial statements present only the financial position, changes in net assets, and cash flows of the City of Lakeland, Department of Electric Utilities (Lakeland Electric) and not of the City as a whole. Lakeland Electric is an enterprise fund that accounts for the City's electric utility operations. These operations are accounted for in a manner similar to private business enterprises where the stated intent is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

Basis of Accounting:

Lakeland Electric uses the accrual basis of accounting in accordance with generally accepted accounting principles (GAAP) as prescribed for enterprise funds by the Governmental Accounting Standards Board (GASB). Lakeland Electric is required to follow the pronouncements of the Financial Accounting Standards Board (FASB) issued through November 30, 1989 that do not conflict with or contradict GASB pronouncements. Lakeland Electric has elected not to apply FASB pronouncements issued after that date. Lakeland Electric has adopted the uniform system of accounts prescribed by the Federal Energy Regulatory Commission (FERC) for electric operations.

Lakeland Electric applies the accounting principles required by Statement of Financial Accounting Standards No. 71 - Accounting for the Effects of Certain Types of Regulation (SFAS 71). Lakeland Electric's rates are designed to recover the cost of providing services, and Lakeland Electric is able to collect those rates from its customers. SFAS 71 requires Lakeland Electric to defer certain expenses and revenues, and record various regulatory assets and liabilities in accordance with rate actions of the Lakeland City Commission.

Cash and Cash Equivalents:

Lakeland Electric has defined Cash and Cash Equivalents to include cash on hand, demand deposits, cash with paying agents, as well as Lakeland Electric's equity in the City's pooled cash (see Note C). Additionally, Lakeland Electric's equity in the City's internal investment pool (see Note C) is considered to be a cash equivalent since Lakeland Electric can deposit or effectively withdraw cash from the pool at any time without prior notice or penalty. Investments that are categorized as cash equivalents on the Balance Sheet are valued at fair market value.

Receivables:

Lakeland Electric has recognized in receivables an estimated amount for services rendered but not yet billed as of September 30, 2006 and 2005, respectively. Receivables are reported net of allowances for uncollectibles where applicable.

Inventories:

Inventories (see Note D) are valued at cost, not in excess of replacement cost, using the weighted average cost method.

Designations:

Lakeland Electric follows the practice of segregating assets, which are designated for some future use. Designations can be rescinded at any time by City Commission approval. Designated assets that are set aside to pay current liabilities are classified as current assets (see Note E).

Due to/from Other Funds:

Amounts receivable from or payable to other funds in the City of Lakeland are reflected in the accounts of the fund until liquidated by payment or authorized inter-fund transactions (see Note M).

Operating/Non-operating Revenue:

Revenues that are earned as a result of the business operations of Lakeland Electric are recorded as operating revenues. Interest earnings and other miscellaneous revenues are recorded as non-operating revenues.

NOTE A -SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Utility Plant:

Lakeland Electric is required to record the acquisition and disposition of assets in accordance with guidelines provided by the Federal Energy Regulatory Commission. Accordingly, fixed assets acquired by Lakeland Electric are recorded at cost for purchased assets. Fixed assets do not include the cost or other value of electric plant contributed. Interest costs on funds used for construction of fixed assets are capitalized as part of the costs of these assets. In accordance with accounting regulations of the Federal Energy Regulatory Commission, electric transformers and certain specialty plant replacement components, which are critical in nature, are classified as utility plant, and depreciated prior to being placed in service.

Routine maintenance, repairs, renewals and replacement costs are charged against operations. Expenditures, which materially increase values, change capacities, or extend useful lives are capitalized.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets as follows:

Land improvements	40 years
Buildings	50 years
Utility Plant	25 - 35 years
Improvements, other than buildings	10 - 45 years
Machinery and equipment	5 - 40 years

Contributions in Aid of Construction:

Non-refundable payments received from consumers and developers for extension of electric services are accounted for as a reduction of utility plant cost in accordance with accounting procedures required by the Federal Energy Regulatory Commission.

Transfers to/From Other Funds:

Lakeland Electric accounts for subsidy payments to other funds as transfers to other funds in the statement of revenues, expenses and changes in net assets. Lakeland Electric makes annual transfers to the City of Lakeland as follows:

	Year Ended September 30	
	2006	2005
Annual dividend to the City of Lakeland	$ 18,000,000	$ 16,125,086
Transfers to City funds for fixed assets	125,000	970,532
Transfers to City Disaster Recovery Fund	-	220,266
Transfer to Fleet Management Fund for new vehicles	15,000	50,103
	$ 18,140,000	$ 17,365,987

A transfer of $31,353 for fixed assets was made to Lakeland Electric during fiscal year 2006 from the City of Lakeland's Department of Information Technology.

Accumulated Unpaid Vacation and Sick Pay:

The amounts of unpaid vacation and sick leave accumulated by Lakeland Electric employees are accrued as expenses when incurred. Total available sick leave hours are multiplied by the current pay rate to determine the accrued liability. The entire unpaid liability for sick leave is classified as a non-current liability based on Lakeland Electric's benefit accrual policies. Lakeland Electric has separated that portion of the liability for vacation time that is expected to be paid from current assets as a current liability. The amount is included in accrued liabilities.

Amortization:

Bond issue costs and bond discount are amortized over the life of the issue using the straight-line method.

NOTE A -SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Derivatives and Interest Rate Swap Agreements:

In June 2003, the Governmental Accounting Standards Board issued Technical Bulletin No. 2003-1, Disclosure Requirements for Derivatives Not Presented at Fair Value on the Balance Sheets. This guidance addresses the disclosure requirements for derivative instruments not reported at fair value on the Balance Sheets including providing information related to the significance of the outstanding derivatives and their associated risks. Derivative instruments are used by Lakeland Electric in conjunction with debt financing and fuel purchases. Fuel related derivative information is included herein and in Note U – Derivatives and Hedging Activities. Debt related derivative information is included in Note O – Revenue Bonds.

Reclassification:

For comparability, certain fiscal year 2005 amounts have been reclassified to conform to the financial statement presentation for fiscal year 2006.

Other Significant Accounting Policies:

Other significant accounting policies are set forth in the financial statements and the notes thereto.

NOTE B – PRIOR PERIOD ADJUSTMENT

During fiscal year 2006, a correction regarding the calculation of the City of Lakeland's net pension obligation (NPO) was made. In prior fiscal years, the employee's annual required contributions and actual contributions were included in the calculation of the NPO. Under the correct policy, only the City's annual required contribution and actual contributions are used in computing the NPO. The net asset balances of Lakeland Electric, as previously reported in the Statement of Revenues, Expenses, and Changes in Fund Net Assets for Proprietary Funds for the year ended September 30, 2005, have been restated based on the correction of the accounting policies. The effect of the restatement is as follows:

	2005	2004
Net assets, as originally stated	$ 274,303,825	$ 284,714,835
Prior period adjustment (cumulative)	(783,907)	(773,396)
Net assets, as restated	$ 273,519,918	$ 283,941,439

NOTE C - CASH, CASH EQUIVALENTS AND INVESTMENTS

Deposits:

All of the City of Lakeland cash accounts have been pooled and all deposits are in a single financial institution and are carried at cost. The deposits are insured or collateralized. Florida Statutes, Chapter 280, sets forth the qualifications and requirements that a financial institution must meet in order to become a qualified public depository. The statute also defines the amount and type of collateral that must be pledged in order to remain qualified. The financial institution in which the City maintains its deposits is a qualified public depository. Refer to the City of Lakeland, Florida comprehensive annual financial report for additional disclosures.

Custodial credit risk is the risk that in the event of a bank failure, the City of Lakeland's deposits may not be returned. Florida Statutes require deposits by governmental units in a financial institution be collateralized. The City of Lakeland's policy, in accordance with the Florida Security for Public Deposits Act, requires deposits in a financial institution be collateralized and requires the use of only authorized dealers and institutions, qualified public depositories, who meet the standards as set forth by the State of Florida and the Securities and Exchange Commission's Rule 15c3-1. In the event of a failure of a qualified public depository, the remaining public depositories would be responsible for covering any resulting losses. Accordingly, all amounts reported as deposits are deemed as insured or collateralized with securities held by the entity or its agent in the entity's name. The carrying amount of Lakeland Electric's share of pooled demand and time deposits with financial institutions as of September 30, 2006, was $54,799,542. By comparison, the carrying amount of Lakeland Electric's pooled demand and time deposits in fiscal year 2005 was a deficit of $2,739,240. The negative balance in time deposits in fiscal year 2005 was offset by other cash equivalents and investments such as pooled investments.

NOTE C - CASH, CASH EQUIVALENTS AND INVESTMENTS (CONTINUED)

Deposits (continued):

The types of investments in which Lakeland Electric may directly invest are governed by several forms of legal and contractual provisions. Lakeland Electric may directly invest in obligations of, or obligations on which the principal of and interest are unconditionally guaranteed by the United States of America, obligations issued or guaranteed by any agency or instrumentality of the United States of America; interest bearing time deposits or repurchase agreements issued by banks, trust companies or national banking associations which are secured by obligations of or guaranteed by the United States of America or its agencies or instrumentalities. Lakeland Electric also may invest monies with the Florida State Board of Administration or other investments which at the time are legal investments under the laws of the State of Florida. Additionally, the various funds of the City have combined some of their resources into an internal investment pool in order to maximize investment earnings. The pool is comprised of money market funds, time deposits, notes, bonds, amounts invested with the Florida State Board of Administration, other securities, and accrued interest.

Lakeland Electric has an equity interest in the City's internal investment pool. There were no violations of legal or contractual provision for deposits and investments during the year. Information regarding credit risk categories for pooled investments is disclosed in the comprehensive annual financial report for the City. Credit risk is the risk of loss due to the failure of the security issuer or other counterparty. The City of Lakeland's investment policy minimizes credit risk by limiting investments in securities that have higher credit risks, pre-qualifying the financial institutions, brokers/dealers, intermediaries, and advisors with which the City will do business, and diversifying the investment portfolio so that potential losses on individual securities will be minimized. As of September 30, 2006, Lakeland Electric's share of the City's Investment Pool debt security investments had the following credit quality ratings:

S&P Rating:	Cost	% of Total	Market	% of Total
AAA	$ 1,361,792	2.22%	$ 1,364,179	2.26%
NR	59,932,291	97.78%	58,959,510	97.74%
	$ 61,294,083	100.00%	$ 60,323,689	100.00%

Moodys Rating:	Cost	% of Total	Market	% of Total
Aaa	$ 41,218,234	67.25%	$ 40,169,998	66.59%
NR	20,075,849	32.75%	20,153,691	33.41%
	$ 61,294,083	100.00%	$ 60,323,689	100.00%

Concentration of Credit Risk:

The City of Lakeland limits investments to avoid over concentration in securities from a specific issuer or business sector (excluding US Treasury securities) and continuously invests a portion of the portfolio in readily available funds such as local government investment pools, money market funds or overnight repurchase agreements. The City of Lakeland's overall investment policy concentration limits and actual concentration limits in investment types as of September 30, 2006 are as follows:

Type of Security (Market)	% of Total Maximum	% of Total
U.S. Government Obligations	100%	1.64%
Local Government Investment Pools	100%	31.73%
Certificates of Deposits	25%	-
Federal Agency & Instrumentality Obligations	100%	63.90%
Collateralized Repurchase Agreements	15%	1.31%
Other Investment Pools (rated "A" or better)	10%	-
Mutual Funds	10%	0.25%
State and Local Government Obligations	5%	-
Bankers Acceptance	5%	-
Commercial Paper	5%	-
Money Market Mutual Funds	10%	1.17%

NOTE C - CASH, CASH EQUIVALENTS AND INVESTMENTS (CONTINUED)

The following table indicates the combined fair value of the City of Lakeland's equity in pooled cash and equity in pooled investments, and Lakeland Electric's share as of September 30, 2006 and 2005:

	Reported Amount Fair Value
As of September 30, 2006:	
Total equity in pooled cash and equity in pooled investments (at market value)	$ 213,472,197
Lakeland Electric's share	$ 101,401,868
As of September 30, 2005:	
Total equity in pooled cash and equity in pooled investments (at market value)	$ 224,949,086
Lakeland Electric's share	$ 100,101,583

There are no violations of legal or contractual provisions for deposits and investments held directly by the investment pool during the year.

Cash, cash equivalents and investments are included in the following captions in the accompanying balance sheets:

	September 30 2006	September 30 2005
Current assets:		
Cash and cash equivalents	$ 20,755,524	$ 16,817,168
Current designated assets:		
Cash and cash equivalents	12,783,925	28,074,648
Designated assets:		
Cash and cash equivalents	45,507,036	70,079,277
Restricted assets		
Cash and cash equivalents	36,076,745	9,110,765
	$ 115,123,230	$ 124,081,858

The equity investment amount reported in the City of Lakeland's Electric Utility Fund represents donated Metals USA Corporation stock having a fair value of $2,683 as of September 30, 2006. The fair value of the investment as of September 30, 2005 was also $2,683.

NOTE D - INVENTORIES

The major classes of inventory consist of the following:

	September 30 2006	September 30 2005
Fuel oil	$ 11,346,706	$ 7,346,706
Coal	4,199,318	3,195,032
Spare parts	14,722,164	15,239,120
	$ 30,268,188	$ 25,780,858

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

NOTE E - CURRENT DESIGNATED ASSETS

Designated assets used to pay designated liabilities that are due within a year of the balance sheet date must be classified as current. The corresponding liabilities must also be classified as current. Lakeland Electric has reclassified the following designated assets and liabilities as current designated assets and liabilities on the balance sheets:

September 30, 2006

	Debt Service Funds	Capital Expansion	Emergency Repair	Total Designated
Cash and cash equivalents	$ 488,930	$ 3,572,474	$ -	$ 4,061,404
Cash with paying agent/trustee	8,722,521	-	-	8,722,521
Unrestricted	$ 9,211,451	$ 3,572,474	$ -	$ 12,783,925
Current portion of revenue bonds payable	$ 575,000	$ -	$ -	$ 575,000
Accounts payable	13,006	3,350,805	-	3,363,811
Accrued expenses	-	221,669	-	221,669
Accrued interest payable	8,623,445	-	-	8,623,445
Current liabilities payable from designated assets	$ 9,211,451	$ 3,572,474	$ -	$ 12,783,925

September 30, 2005:

	Debt Service Funds	Capital Expansion	Emergency Repair	Total Designated
Cash and cash equivalents	$ 352,637	$ 3,712,626	$ 27,951	$ 4,093,214
Cash with paying agent/trustee	23,981,434	-	-	23,981,434
Unrestricted	$ 24,334,071	$ 3,712,626	$ 27,951	$ 28,074,648
Current portion of revenue bonds payable	$ 15,095,000	$ -	$ -	$ 15,095,000
Accounts payable	350,800	3,392,112	-	3,742,912
Accrued expenses	-	320,514	-	320,514
Accrued interest payable	8,888,271	-	-	8,888,271
Deferred revenue	-	-	27,951	27,951
Current liabilities payable from designated assets	$ 24,334,071	$ 3,712,626	$ 27,951	$ 28,074,648

NOTE F - OTHER CURRENT ASSETS

Lakeland Electric maintains an index margin account used for fuel hedging which is classified under Other Current Assets, under the category of prepaid fuel. Total Other Current Assets are comprised of the following:

	September 30	
	2006	2005
Prepaid fuel	$ 40,994,035	$ 4,046,642
Prepaid Maintenance - McIntosh 5 Unit	3,926,223	-
Other prepaid expenses	-	61,161
	$ 44,920,258	$ 4,107,803

NOTE G - DEFERRED REGULATORY CHARGES

SFAS No. 71 requires public utilities to recognize revenues provided either before or after the costs are incurred as assets or liabilities. Lakeland Electric's deferred regulatory charges represent the cumulative under recovery of fuel costs related to retail electric customers.

	September 30 2006	September 30 2005
Deferred regulatory charges, beginning balance	$ 12,167,670	$ 6,035,022
Fuel expenses	245,647,991	203,486,274
Less fuel charges recovered	250,077,712	197,353,626
Deferred regulatory charges, ending balance	$ 7,737,949	$ 12,167,670

NOTE H - RESTRICTED ASSETS

The revenue bond ordinances and certain other agreements require the restriction of certain assets for specific purposes. The Meter Deposit Reserve is currently Lakeland Electric's only restricted fund. Restricted assets and liabilities payable from restricted assets in Lakeland Electric as of September 30, 2006 and 2005 consist of the following:

	Bond Proceeds	Customer Deposits	Total Restricted
September 30, 2006:			
Cash and cash equivalents	$ 26,444,380	$ 9,632,365	$ 36,076,745
Accounts receivable	1,922,142	-	1,922,142
Restricted assets	28,366,522	9,632,365	37,998,887
Accounts payable	$ 13,964	$ -	$ 13,964
Accrued expenses	41,920	-	41,920
Meter deposits payable	-	12,714	12,714
Accrued interest payable	-	9,619,651	9,619,651
Liabilites payable from restricted assets	$ 55,884	$ 9,632,365	$ 9,688,249

	Bond Proceeds	Customer Deposits	Total Restricted
September 30, 2005:			
Cash and cash equivalents	$ -	$ 9,110,765	$ 9,110,765
Meter deposits payable	$ -	$ 8,059	$ 8,059
Accrued interest payable	-	9,102,706	9,102,706
Restricted Assets	$ -	$ 9,110,765	$ 9,110,765

NOTE I - DESIGNATED ASSETS

The City of Lakeland and Lakeland Electric have established long range plans concerning Lakeland Electric. As part of the plan to achieve its objectives, the City Commission has set aside certain assets that will be used to fund its plans for future expansion. Debt service funds are also set aside monthly and designated for the purpose of paying current principle and interest requirements. Designated assets of Lakeland Electric consist of the following:

September 30, 2006:	Debt Service Funds	Capital Expansion	Emergency Repair	Total Designated
Cash and cash equivalents	$ -	$ 36,766,002	$ 8,741,034	$ 45,507,036
Due from/(to) other governments	105,340	(812,067)	-	(706,727)
Advances to other funds	13,408,885	-	-	13,408,885
Designated assets	$ 13,514,225	$ 35,953,935	$ 8,741,034	$ 58,209,194

September 30, 2005:	Debt Service Funds	Capital Expansion	Emergency Repair	Total Designated
Cash and cash equivalents	$ -	$ 61,886,679	$ 8,192,598	$ 70,079,277
Accounts receivable	-	599,692	61,985	661,677
Due from other governments	-	1,770,243	127,841	1,898,084
Advances to other funds	13,434,020	-	-	13,434,020
Designated assets	$ 13,434,020	$ 64,256,614	$ 8,382,424	$ 86,073,058

NOTE J - OTHER ASSETS

Other Assets (noncurrent) consist of the following:

	September 30 2006	September 30 2005
Unamortized bond issue cost	$ 6,835,807	$ 4,957,822
Net pension obligation (assets), as restated, Note B	3,367,265	3,354,359
	$ 10,203,072	$ 8,312,181

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

NOTE K - UTILITY PLANT

Utility plant consists of the following:

Fiscal year 2006:	September 30, 2005	Additions	Deletions	September 30, 2006
Non-Depreciable Assets:				
Land	$ 15,254,331	$ 92,767	$ 150,000	$ 15,197,098
Construction in process	20,385,220	23,193,988	22,807,424	20,771,784
Depreciable Assets:				
Buildings	30,184,466	-	294,886	29,889,580
Machinery and equipment	37,256,614	2,002,877	4,196,351	35,063,140
Electric transmission and distribution	330,508,195	12,536,051	2,853,117	340,191,129
Electric production plant in service	622,201,668	8,927,627	704,894	630,424,401
	1,055,790,494	46,753,310	31,006,672	1,071,537,132
Less accumulated depreciation:				
Buildings	9,268,096	734,151	160,663	9,841,584
Machinery and equipment	17,557,707	3,874,219	4,070,196	17,361,730
Electric transmission and distribution	114,365,678	9,351,156	1,588,363	122,128,471
Electric production plant in service	292,398,941	24,746,456	473,466	316,671,931
	433,590,422	38,705,982	6,292,688	466,003,716
Total utility plant	$ 622,200,072	$ 8,047,328	$ 24,713,984	$ 605,533,416

Fiscal year 2005:	September 30, 2004	Additions	Deletions	September 30, 2005
Non-Depreciable Assets:				
Land	$ 11,081,754	$ 4,172,577	$ -	$ 15,254,331
Construction in process	27,214,886	34,429,705	41,259,371	20,385,220
Depreciable Assets:				
Buildings	30,184,466	-	-	30,184,466
Machinery and equipment	39,618,673	2,315,107	4,677,166	37,256,614
Electric transmission and distribution	321,048,245	10,918,398	1,458,448	330,508,195
Electric production plant in service	609,222,480	35,154,241	22,175,053	622,201,668
	1,038,370,504	86,990,028	69,570,038	1,055,790,494
Less accumulated depreciation:				
Buildings	8,433,390	834,706	-	9,268,096
Machinery and equipment	17,241,051	4,008,912	3,692,256	17,557,707
Electric transmission and distribution	106,011,523	9,630,717	1,276,562	114,365,678
Electric production plant in service	269,485,047	23,028,098	114,204	292,398,941
	401,171,011	37,502,433	5,083,022	433,590,422
Total utility plant	$ 637,199,493	$ 49,487,595	$ 64,487,016	$ 622,200,072

NOTE K - UTILITY PLANT (CONTINUED)

In accordance with Statements of Financial Accounting Standards (SFAS) Nos. 34 and 62, Lakeland Electric has adopted the policy of capitalizing net interest costs on funds used for the construction of fixed assets. In accordance with the provisions of these statements, net interest costs have been capitalized as follows:

	Year ended September 30	
	2006	2005
Amount Capitalized:		
Interest expense	$ 453,631	$ 539,433
Less: Interest revenue	142,441	-
Net interest capitalized	$ 311,190	$ 539,433
Total interest expense	$ 23,603,434	$ 23,872,472
Less: Interest expense capitalized	311,190	539,433
Interest expense	$ 23,292,244	$ 23,333,039

NOTE L - UTILITY PLANT PARTICIPATION AGREEMENT

On April 4, 1978, the City entered into a fifty-year participation agreement with the Orlando Utilities Commission. Under the terms of this agreement, the City of Lakeland has a 60 percent interest and Orlando Utilities Commission a 40 percent interest in McIntosh Unit #3, a 364-megawatt coal-fired steam generating unit. The Orlando Utilities Commission constructed, at its expense, a 230 KV transmission line to deliver its share of the output to its service area.

The City has operational control of this project and accounts for its undivided ownership interest based on its pro-rata share of the project's construction costs and operating expenses.

The City of Lakeland issued revenue bonds to cover a portion of its investment in the plant. Orlando Utilities Commission also issued revenue bonds to cover a portion of its investment in the plant and the cost of its 230 KV transmission line. Each participant is solely responsible for its debt issued.

NOTE M - DUE TO OTHER FUNDS

Due to other funds consists of the following:

	September 30	
	2006	2005
Fleet Management Fund	$ 22,500,000	$ -
Wastewater Renewal and Replacement Fund	10,000,000	-
Lakeland Linder Regional Airport Fund	3,244,035	-
Water Renewal and Replacement Fund	5,250,000	-
Department of Information Technology Fund	137,473	137,473
	$ 41,131,508	$ 137,473

An inter-fund loan of $137,473 from the Department of Information Technology represents the current portion of an advance in each of fiscal years 2005 and 2006 related to the purchase of computer equipment. The remaining $40,994,035 represents the dollar value of cash on deposit within the margin account maintained by Lakeland Electric in conjunction with the fuel hedging program. On September 30, 2006, the utility entered into a short-term inter-fund loan with other non-restricted funds of the City in an amount equal to the dollar value of cash on deposit in that margin account. In November of 2006, that margin account was closed and this short-term inter-fund loan was retired. (See notes F and X).

NOTE N - LONG-TERM DEBT

Long term debt consists of the following:

	September 30 2006	September 30 2005
Revenue bonds payable, less current portion	$ 522,710,409	$ 492,385,409
Less unamortized loss on refunding	(20,173,964)	(22,148,686)
Plus unamortized bond discount (net of premium)	2,302,210	1,152,901
	$ 504,838,655	$ 471,389,624

NOTE O - REVENUE BONDS

Revenue bonds payable as of September 30, 2006:

	Interest Rate %	Final Maturity	September 30, 2005	Additions	Deletions	September 30, 2006
Series 1999A	3.05 to 5.00	10-01-2036	$ 193,785,409	$ -	$ 555,000	$ 193,230,409
Series 1999B	5.30 to 6.05	10-01-2014	81,310,000	-	30,125,000	51,185,000
Series 1999C	5.30 to 6.05	10-01-2012	64,525,000	-	-	64,525,000
Series 2001A	Variable	10-01-2035	90,000,000	-	90,000,000	-
Series 2001B	5.00 to 5.50	10-01-2018	30,000,000	-	-	30,000,000
Series 2003	Variable	10-01-2037	47,860,000	-	47,860,000	-
Series 2006	Variable	10-01-2016	-	44,870,000	-	44,870,000
Series 2006A	Variable	10-01-2037	-	139,475,000	-	139,475,000
			$ 507,480,409	$ 184,345,000	$ 168,540,000	$ 523,285,409
Less current portion			(15,095,000)			(575,000)
			$ 492,385,409			$ 522,710,409

A portion of series 1999A bonds was allocated from Lakeland Electric to the Water Utility Fund in fiscal year 2001. During fiscal year 2002, Lakeland Electric assumed long-term debt from the Water Utility Fund in the amount of $13,434,020, which was offset by an Advance to Other Funds (designated assets, Note I).

Lakeland Electric issued Series 2006 ($44,870,000) and Series 2006A ($139,475,000) variable rate refunding and revenue bonds during August 2006 for the purpose of financing certain capital improvements and to refund, on a current basis, outstanding variable rate energy system revenue bonds Series 2001A and Series 2003 and a portion of Series 1999B energy system revenue bonds. These transactions resulted in a loss on refunding of $6,073,130, which is being amortized over the remaining life of the refunding bond issue.

NOTE O - REVENUE BONDS (CONTINUED)

The following is a schedule of the debt service requirements, excluding the current portion for outstanding revenue bonds, as of September 30, 2006:

	Series 1999A Sr.		Series 1999B Sr.	
Fiscal Year(s)	Principal	Interest	Principal	Interest
2007	$ 600,000	$ 7,819,294	$ 11,130,000	$ 3,198,035
2008	625,000	7,795,294	12,005,000	2,469,020
2009	6,700,719	11,683,794	12,740,000	1,760,725
2010	6,307,218	12,082,295	-	926,255
2011	5,952,510	12,437,003	-	926,255
2012-2016	37,889,962	54,238,876	15,310,000	2,366,458
2017-2021	44,820,000	27,922,788	-	-
2022-2026	22,995,000	20,253,000	-	-
2027-2031	29,330,000	13,902,000	-	-
2032-2036	37,435,000	5,797,500	-	-
2037-2041	-	-	-	-
	$ 192,655,409	$ 173,931,844	$ 51,185,000	$ 11,646,748

	Series 1999C Sr.		Series 2001B Sr.		Series 2006 Sr.	
Fiscal Year(s)	Principal	Interest	Principal	Interest	Principal	Interest
2007	$ 5,095,000	$ 3,903,763	$ -	$ 1,561,100	$ 475,000	$ 2,145,492
2008	5,370,000	3,595,515	-	1,561,100	760,000	2,126,494
2009	5,775,000	3,270,630	-	1,561,100	785,000	2,096,094
2010	14,865,000	2,921,243	-	1,561,100	820,000	2,064,694
2011	16,180,000	2,021,910	-	1,561,100	855,000	2,031,894
2012-2016	17,240,000	1,043,020	20,675,000	5,893,725	4,865,000	9,553,169
2017-2021	-	-	9,325,000	705,000	6,085,000	8,331,144
2022-2026	-	-	-	-	7,755,000	6,661,063
2027-2031	-	-	-	-	9,895,000	4,518,563
2032-2036	-	-	-	-	12,575,000	1,847,750
2037-2041	-	-	-	-	-	-
	$ 64,525,000	$ 16,756,081	$ 30,000,000	$ 14,404,225	$ 44,870,000	$ 41,376,355

	Series 2006A		TOTAL		
Fiscal Year(s)	Principal	Interest	Principal	Interest	Total
2007	$ -	$ 5,460,446	$ 17,300,000	$ 24,088,130	$ 41,388,130
2008	-	5,460,446	18,760,000	23,007,869	41,767,869
2009	-	5,460,446	26,000,719	25,832,789	51,833,508
2010	-	5,460,446	21,992,218	25,016,033	47,008,251
2011	-	5,460,446	22,987,510	24,438,608	47,426,118
2012-2016	-	27,302,231	95,979,962	100,397,479	196,377,441
2017-2021	4,575,000	27,302,231	64,805,000	64,261,163	129,066,163
2022-2026	25,700,000	24,477,559	56,450,000	51,391,622	107,841,622
2027-2031	31,575,000	19,006,346	70,800,000	37,426,909	108,226,909
2032-2036	57,900,000	11,238,986	107,910,000	18,884,236	126,794,236
2037-2041	19,725,000	772,234	19,725,000	772,234	20,497,234
	$ 139,475,000	$ 137,401,819	$ 522,710,409	$ 395,517,072	$ 918,227,481

NOTE O - REVENUE BONDS (CONTINUED)

Lakeland Electric's bond coverage calculation changed significantly under the 1999 first lien bond ordinance. The following is a schedule of combined senior and junior lien revenue bond coverage for fiscal year 2006 and the previous five years per the current senior lien ordinance:

Fiscal Year	Net Revenues Available	Debt Service Principal	Debt Service Interest	Total Debt Service	Coverage from Operations	Bond Ordinance Coverage
2006	$ 68,205,780	$ 575,000	$ 23,093,002	$ 23,668,002	2.88	4.01
2005	70,264,993	15,095,000	22,439,513	37,534,513	1.87	2.77
2004	78,217,987	13,250,000	22,462,844	35,712,844	2.19	3.08
2003	80,925,142	11,745,000	23,450,154	35,195,154	2.30	3.02
2002	77,822,193	12,550,000	25,486,731	38,036,731	2.05	2.99
2001	82,418,084	10,085,000	24,792,204	34,877,204	2.36	2.98

Bond debt coverage for the year ended September 30, 2006 was calculated as follows:

Charges for services	$ 377,047,401	
Investment and other income	4,918,727	
Total revenue		$ 381,966,128
Less cost of operations		(313,760,348)
Net revenues from operations available for debt service		68,205,780
Fund balance (as defined by bond ordinance):		
Cash and equivalents	$ 20,755,524	
Designated current assets:	12,783,925	
Accounts receivable (net of uncollectables)	55,419,542	
Designated assets (excluding advances to other funds)	44,800,309	
	$ 133,759,300	
20% of fund balance		26,751,860
Net available revenues plus 20% of fund balance		$ 94,957,640
Debt service requirement:		
Interest		$ 23,093,002
Principal		575,000
Total		$ 23,668,002
Bond coverage		4.01
Bond coverage from operations		2.88

The above calculation incorporates the impact of advance refunding of a portion of the Electric and Water Revenue Bonds Series 1999B in August of 2006. The total amount of principal and interest refunded was $16,095,408.

NOTE O - REVENUE BONDS (CONTINUED)

All of the outstanding revenue bonds are secured by a first lien on and pledge of the net revenues of the Electric system. As of September 30, 2006, all funds and accounts required by the bond ordinance were being maintained in conformance with the ordinance.

Interest Rate Swaps:

As a means to partially hedge the variable rate risk exposure associated with the issuance of the $90,000,000 2001A Energy System Variable Rate Revenue Bonds in April of 2001, the City entered into a basis swap in May of 2001. Under the swap, the City pays CitiGroup Financial Products Inc. (the counterparty) a payment equal to $90,000,000 (the notional amount) times an interest rate equal to the BMA Municipal Bond Index. In return, the counterparty pays the City an amount equal the notional amount times 74.125% of the monthly USD-LIBOR-BBA rate. To the extent the relationship between BMA and LIBOR approximates a marginal tax rate of more than 25.875 percent; the net borrowing cost on the underlying 2001 debt issue will be reduced as a result of this swap. The notional amount remains unchanged over the term of the swap, which ends May 1, 2021. Settlement payments are made quarterly. As of September 30, 2006, the swap had a negative fair value of $71,610 developed using the Market Quotation method. The negative fair value may be countered by reductions in future net interest payments on the underlying debt resulting from the swap. As of September 30, 2006, the City was not exposed to credit risk because the swap had a negative fair value. The City is exposed to basis risk to the extent the relationship of BMA to LIBOR increases to greater than 74.125 percent. The derivative contract uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay, bankruptcy, or a rating downgrade by Moody's or S&P issued to either the City or the counterparty..

In order to reduce borrowing costs when compared to the market rates paid by issuers of fixed–rate bonds as of November 2002, the City entered into a forward swap in connection with the issuance of the Energy System Variable Rate Refunding Revenue Bonds Series 2003, which were sold in January 2003. Under the swap, the City pays CitiGroup Financial Products Inc. (the counterparty) a payment equal to $47,860,000 (the notional amount) times a fixed interest rate of 3.74 percent. In return, the counterparty pays the City an amount equal the notional amount times 67 percent of the monthly USD-LIBOR-BBA. To the extent the relationship between BMA and LIBOR approximates a marginal tax rate of more than 33 percent; the synthetically fixed rate paid on underlying bonds is equal to 3.74 percent plus the cost of liquidity and remarketing fees on the underlying variable rate issue. The notional amount of the swap was structured to correspond with the maturity schedule on the Series 2003 bonds. Settlement payments on this swap are made monthly. As of September 30, 2006, the swap had a negative fair value of $1,671,650 developed using the Market Quotation method. The negative fair value may be countered by reductions in total net interest payments on the underlying debt resulting from the swap. As of September 30, 2006, the City was not exposed to credit risk because the swap had a negative fair value. The City is exposed to basis risk to the extent the relationship of BMA to LIBOR increases to greater than 33 percent. The derivative contract uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. An additional termination event also occurs in the event of a rating downgrade by Moody's or S&P issued to either the City or the counterparty.

In August of 2006, the City retired both of the Energy System Variable Rate Revenue Bonds, Series 2001A and the System Variable Rate Refunding Revenue Bonds Series 2003. These two bond issue were replaced by the Energy System Refunding Revenues Bonds Series 2006A. The annual maturity dates and maturity amounts for the refunding and refunded bonds are essentially identical. The replacement bonds take the form of Period Auction Rate Securities (PARS) versus the Variable Rate Demand Obligations (VRDO's) they replaced. The City elected to retain the financial benefits of the basis risk associated with the aforementioned swap transactions and integrate those swaps into the refunding bond issue. Accordingly, the pre-existing swaps related to the 2001A and 2003 Bonds now apply to the 2006A Refunding Bonds.

NOTE O - REVENUE BONDS (CONTINUED)

Interest Rate Swaps (continued)

In March of 2006 the City entered into two "forward-starting floating to fixed rate" swaps having notional amounts of $90,000,000. The purpose of these swaps was to hedge the exposure to changes in variable interest rates by synthetically establishing a fixed interest rate on $90,000,000 of the Energy System Refunding Revenues Bonds Series 2006A issued in August 2006. Under the swap, the City pays the counterparty a payment equal to $90,000,000 (the notional amount) times a fixed interest rate of 4.283 percent (annualized). In return, the counterparty pays the City an amount equal the notional amount times the weighted average BMA Municipal Bond Index. This exchange of cash flows occurs quarterly. This swap transaction was split between two counterparties; Goldman Sachs in the amount of $60,000,000 and CitiGroup Financial Products Inc in the amount of $30,000,000. The combined notional amount of the swaps decreases over time based on the bond maturity schedule associated with a portion of the Energy System Refunding Revenues Bonds Series 2006A ($90,000,000) allocated to refunding the Energy System Variable Rate Revenue Bonds, Series 2001A. As of September 30, 2006, the two swaps had a combined negative fair value of $3,407,812 developed using the Market Quotation method. The negative fair value may be countered by reductions in future net interest payments on the underlying debt resulting from the swap. As of September 30, 2006, the City was not exposed to credit risk because the swap had a negative fair value.

The City is exposed to basis risk to the extent the relationship of BMA and the actual interest rate paid on the underlying bonds varies over time. The derivative contract uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. An additional termination event also occurs in the event of a rating downgrade by Moody's or S&P issued to either the City or the counterparty.

As of September 30, 2006, future debt service requirements on the $139,475,000 of variable-rate debt issued in conjunction with the Series 2006A bond issue and net swap payments based on the terms in each of the underlying swaps appear as follows. These calculations are based on an average rate of interest paid on the underlying bonds of 3.65 percent as of September 30, 2006; and effective LIBOR interest rate of 5.322 percent as of September 30, 2006 As rates vary, variable rate bond interest payments and net swap payments will vary.

Ending	Variable-Rate Bonds		Interest Rate	
September 30,	Principal	Interest	Swaps, Net	Total
2007	$ -	$ 5,460,446	$ 387,662	$ 5,848,108
2008	-	5,460,446	387,662	5,848,108
2009	-	5,460,446	387,662	5,848,108
2010	-	5,460,446	387,662	5,848,108
2011	-	5,460,446	387,662	5,848,108
2012-2016	-	27,302,231	1,938,308	29,240,539
2017-2021	4,575,000	27,302,231	2,048,908	33,926,139
2022-2026	25,700,000	24,477,559	2,810,596	52,988,155
2027-2031	31,575,000	19,006,346	1,938,799	52,520,145
2032-2036	57,900,000	11,238,986	839,037	69,978,023
2037-2041	19,725,000	772,234	34,364	20,531,598
	$ 139,475,000	$ 137,401,817	$ 11,548,322	$ 288,425,139

As a means to reduce borrowing costs on a portion of the Electric and Water Refunding Revenue Bonds Series 1999A the City entered into an interest rate swap in June 2004. Under the swap, the City pays CitiGroup Financial Products Inc. (the counterparty) a payment equal to $159,265,000 (the notional amount) times an interest rate equal to the BMA Municipal Bond index.

NOTE O - REVENUE BONDS (CONTINUED)

Interest Rate Swaps (continued)

In return for the payment, the counterparty pays the City an amount equal the notional amount times an interest rate equal to 68 percent of the three-month USD-LIBOR-BBA index, plus a spread of .046%. To the extent the relationship between BMA and LIBOR approximates a marginal tax rate of more than 33 percent; the net borrowing costs on the underlying debt will be reduced. The notional amount of the swap will always equal the amount of the outstanding amount of that component of the underlying issue consisting of term bonds which mature serially from October 2004 thru October 2036. Settlement payments are made semi-annually. As of September 30, 2006, the swap had a positive fair value of $1,487,838 developed using the Market Quotation method. The positive fair value may be countered by changes in total net interest payments on the underlying debt resulting from the swap. The City is exposed to basis risk to the extent the relationship of BMA to LIBOR increases to greater than 33 percent. The derivative contract uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay, bankruptcy, or a rating downgrade by Moody's or S&P issued to either the City or the counterparty. As of September 30, 2006, the City was exposed to credit risk because the swap had a positive fair value. If the swap had been terminated on September 30, 2006, the City would have relied on its counterparty to make a payment to the City equal to the fair market value.

As of September 30, 2006, future payments on the 2004 swap are estimated as follows. These calculations are based on the amortization of the swap consistent with the outstanding principal of the 199A bonds, and year-end BMA and 3 Month LIBOR Rates of 3.74% and 5.32%, respectively.

Fiscal Year Ending September 30,	BMA Payment (From City)	LIBOR Payment (To City)	Net Payment (To City)
2007	$ 5,910,258	$ 6,497,459	$ 587,201
2008	5,896,337	6,473,303	576,966
2009	5,857,330	6,448,119	590,789
2010	5,853,661	6,435,271	581,610
2011	5,853,661	6,435,271	581,610
2012-2016	29,076,047	31,956,178	2,880,131
2017-2021	21,877,471	24,056,458	2,178,987
2022-2026	15,559,802	17,104,564	1,544,762
2027-2031	10,923,098	12,006,180	1,083,082
2032-2036	5,005,527	5,500,396	494,869
2037-2041	153,995	169,295	15,300
	$ 111,967,187	$ 123,082,494	$ 11,115,307

In March of 2006 the City entered into a forward-starting floating to fixed rate swap having a notional amount of $45 million. The purpose of this swap was to hedge the exposure to changes in variable interest rates by synthetically establishing a fixed interest rate on $45 million of Energy System Refunding Revenues Bonds Series 2007 anticipated to be issued in August 2007. Under the swap, the City pays the counterparty a payment equal to $45 million (the notional amount) times a fixed interest rate of 3.637 percent (annualized). In return, the counterparty pays the City an amount equal the notional amount times 67 percent of the weighted average on month LIBOR rate. This exchange of cash flows occurs quarterly. The counterparty on this swap transaction is Goldman Sachs. The notional amount of the swap decreases over time based on the bond maturity schedule anticipated to be associated with the Energy System Refunding Revenues Bonds Series 2007. As of September 30, 2006, the swap had a negative fair value of $662,758,812 developed using the Market Quotation method. The negative fair value may be countered by reductions in future net interest payments on the underlying debt resulting from the swap. As of September 30, 2006, the City was not exposed to credit risk because the swap had a negative fair value.

NOTE O - REVENUE BONDS (CONTINUED)

Interest Rate Swaps (continued)

The City is exposed to basis risk to the extent the relationship of BMA the actual interest rate paid on the underlying bonds varies over time. The derivative contract uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. An additional termination event also occurs in the event of a rating downgrade by Moody's or S&P issued to either the City or the counterparty.

NOTE P – DEFERRED REVENUE

Deferred revenue classified as a current liability consists of the following:

	September 30	
	2006	2005
Deferred revenue, McIntosh Unit 5 maintenance contract	$ -	$ 936,289
Deferred gain on fuel hedges	-	18,804,074
	$ -	$ 19,740,363

The deferred gain on fuel hedges represents the positive market value (if any) of natural gas hedge contracts purchased on the NYMEX exchange. To the extent this value (if any) exceeds the dollar value of Prepaid Fuel (see Note F), the broker advanced cash to Lakeland Electric representing the extent that this market value exceeds the minimum margin requirement

NOTE Q - EMPLOYEE RETIREMENT SYSTEM

The City maintains and administers an Employee Pension and Retirement System Plan which is a single employer, defined benefit pension plan. It covers substantially all full-time, regular employees of the City. The Plan is funded from contributions provided by both the employer and employees. The plan is subject to periodic review by an independent actuary to determine the required funding level upon which the City bases the annual contributions.

Contributions – Employee contributions are recorded in the period in which they are payroll deducted from plan participants. Contributions from the City are made and recorded at the same time. The contribution rates are 8 percent for the employee portion and 14.4 percent for the City portion.

Pension Benefits – Plan participants as of September 30, 2003, may retire, without penalty, after attaining age 60 and contributing 10 or more years to this plan. The monthly benefit is determined by multiplying the average monthly salary by a service and benefit factor. The average monthly salary is computed using the average of the highest total earnings over a consecutive period of 36 months. The service factor is based on the length of continuous service determined as follows: 3 percent per year for the first 25 years of service plus 1 percent per year for all service above 25 years.

Plan participants who enter the plan on or after October 1, 2003, with 10 years or more of service may retire at normal retirement age of 62. The retirement income for an employee who retires on the normal retirement date will equal 2 percent of the highest total earnings over a consecutive period of 60 months multiplied times the number of years of credit service up to 10 years; 3 percent of the same average earnings for the next 20 years of credited service; and 1 percent per year of the same average for each year of service in excess of 30 years.

NOTE Q - EMPLOYEE RETIREMENT SYSTEM (CONTINUED)

Pension Benefits (continued)

The Plan includes a provision for an annual across-the-board increase in the benefit paid to all retirees if certain conditions occur. The amount of the annual increase, if any, is a factor of the investment performance of the Plan for the preceding year considered in relation to the actuarially assumed rate of investment return.

Termination Benefits - if a member employee is terminated, either voluntarily or involuntarily, the following benefits are payable: if the employee has less than 10 years of credited service, the employee shall be entitled to a refund of amounts contributed by the employee. If the employee has ten or more years credited service, the employee will be entitled to the accrued monthly retirement benefit to commence on normal retirement date, provided the employee's contributions are left in the fund. A terminated employee may also elect an early retirement benefit as described above. The authority for establishing or amending the benefit provisions and contribution provisions is contained in City ordinances.

For the following information, refer to the City of Lakeland, Florida, Employees' Pension and Retirement System stand-alone financial statements which can be obtained by contacting the City of Lakeland, Finance Department, City Hall, 228 S. Massachusetts Ave., Lakeland, FL 33801-5086:

Annual pension cost
Dollar amount of contributions
Date of Actuarial valuation
Identification of actuarial method and assumptions
Required supplemental information

NOTE R - POST-EMPLOYMENT BENEFITS

In addition to the pension benefits described in Note Q, the City Commission has agreed to offer subsidized post-employment health care benefits to former employees who are receiving retirement benefits from the City.

On May 1, 1989 the City Commission agreed to subsidize 50 percent of the cost of Part A Medicare insurance coverage purchased by any person receiving retirement benefits from the City of Lakeland. This agreement can be rescinded by the City at any time. To date, there have been no participants in this program.

On September 18, 1989 the City Commission agreed to subsidize the cost of health insurance coverage offered to any person receiving retirement benefits from the City of Lakeland. Effective September 22, 2002, the retirees' health insurance premium subsidy of 50 percent was reduced as follows: in fiscal year 2004 to 45 percent, in fiscal year 2005 to 40 percent, and in subsequent fiscal years to 35 percent. Effective October 1, 2002 the health insurance premium subsidy is based on years of service. Retirees are required to make an election as to participation in the City-sponsored health insurance plan upon retirement. Effective January 1, 2004, any employee who wishes to have his/her spouse and dependents insured will be required to have them on the plan for one year prior to retirement. Should a participant at any time elect not to purchase coverage from the City-sponsored plan, all eligibility for future participation in that plan, including rights to the subsidy, are terminated. The subsidy program can be terminated by the City at any time. During the fiscal year ended September 30, 2006, retirees from the Utilities who participated in the plan incurred total costs of $402,015 paid by the City. The subsidy is funded on a pay-as-you-go basis with the cost being charged to the insurance expense accounts of the fund that paid the salary of each participant during his or her tenure as an employee.

NOTE S - BUSINESS SEGMENT

The Lakeland Electric operates in only one business segment, that of providing electric utility service. Its' service area is primarily the City of Lakeland, Florida and the immediate area surrounding the City.

NOTE T - DEFERRED COMPENSATION PROGRAM

The City has a Deferred Compensation Program pursuant to Chapter 75-295, as amended by Chapter 76-279, Florida Statutes. In accordance with the Deferred Compensation Program, the City may, by contract and/or collective bargaining agreement, agree with any City employee to defer up to 25 percent of an employee's gross salary (not to exceed $13,000 in one year). Under the terms of the program, the City may purchase, at the direction of the employee, fixed or variable life insurance, annuity contracts or mutual fund shares for the purpose of "informally" funding the deferred compensation agreements of the employee. The investments will, at all times, remain solely the property of the employee, held in trust until the employee is eligible to draw the amounts contributed. The compensation deferred under the program is not included in employees' taxable income until such amounts are actually received by employees under the terms of the program.

NOTE U – DERIVATIVE AND HEDGING ACTIVITIES

Accounting for Derivatives and Hedging Activities:

Fuel related derivative transactions are executed in accordance with fuel hedging policies established by Lakeland Electric's Energy Risk Management Oversight Committee. The primary objective of these policies is to minimize exposure to natural gas price volatility for cash flow and control purposes. The Committee has a defined organizational structure and responsibilities, which include approving all brokerage relationships, counterparty credit worthiness, specific fuel volumes and financial limits in addition to overall program compliance.

The recording of fuel derivatives, when appropriate, is included on the Statements of Net Assets as either an asset or liability measured at fair market value. Related gains and/or losses are deferred and recognized in the specific period in which the derivative is settled and included as a part of Fuel and Purchased Power cost in the Statements of Revenues, Expenses and Changes in Net Assets.

Recent Accounting Pronouncements:

In June 2003, the GASB issued Technical Bulletin No. 2003-1, Disclosure Requirements for Derivatives Not Presented at Fair Value on the Statement of Net Assets. This guidance addresses the disclosure requirements for derivative instruments not reported at fair value on the Statement of Net Assets including providing information related to the significance of the outstanding derivatives and their associated risks. Derivative instruments are used by Lakeland Electric in conjunction with debt financing and fuel purchases. Fuel related derivative information is included herein and Debt related derivative information is included in Note O – Revenue Bonds, Interest Rate Swaps.

Derivative instruments:

Fuel related derivative transactions are executed in accordance with fuel hedging policies established by Lakeland Electric's Energy Risk Management Oversight Committee. The primary objective of these policies is to minimize exposure to natural gas price volatility for cash flow and control purposes. The Committee has a defined organizational structure and responsibilities, which include approving all brokerage relationships, counterparty credit worthiness, specific fuel volumes and financial limits in addition to overall program compliance.

The City of Lakeland uses the New York Mercantile Exchange (NYMEX), natural gas futures contracts, over the counter swaps, options on futures contracts, swing-swaps, and fixed-priced firm physical purchases of natural gas as tools to establish the cost of natural gas that will be needed by the City in the future. NYMEX futures contracts can be used to obtain physical gas supplies; however, all futures contracts the City enters into will be financially settled before physical settlement is required by the Exchange. Any gain or loss of the value of these futures contracts and over-the-counter swaps are ultimately rolled into the price of natural gas burned, offsetting the volatility in the price of that fuel.

NOTE U – DERIVATIVE AND HEDGING ACTIVITIES (CONTINUED)

Derivative instruments (continued):

At September 30, 2006, the City of Lakeland had the following futures, options, swaps, and physical contracts outstanding in the following amounts, covering fiscal years 2007 to 2014:

	Thousands of MMBtu				Mark-to- Market
Fiscal Year	Futures	Options	Swaps	Physicals	Value at 9/30/06
2007	11,950	1,120	1,893	3,970	$ (25,892,354)
2008	2,900	-	1,135	2,068	(4,744,277)
2009	200	-	920	3,655	(2,411,068)
2010	-	-	920	460	(201,420)
2011	-	-	920	-	(336,420)
2012	-	-	920	-	(237,875)
2013	-	-	920	-	(199,891)
2014	-	-	155	-	(728)
	15,050	1,120	7,783	10,153	$ (34,024,033)

The physical contracts and over-the-counter swaps are not presented at fair value on the Statement of Net Assets and are disclosed in the above table.

The recording of financial fuel derivatives, when appropriate, is included on the Statements of Net Assets as either an asset or liability measured at fair market value. Related gains and/or losses are deferred and recognized in the specific period in which the derivative is settled and included as a part of Fuel and Purchased Power cost in the Statements of Revenues, Expenses and Changes in Net Assets. The valuation of market changes for Lakeland Electric's Energy Risk Management Program resulted in the recognition of an additional $27,133,233 in fuel and purchased power expense during fiscal year 2006.

NOTE V - LITIGATION

Various suits and claims arising in the ordinary course of operations are pending against Lakeland Electric. While the ultimate effect of such litigation cannot be ascertained at this time, in the opinion of counsel for Lakeland Electric, the liabilities which may arise from such actions would not result in losses which would materially affect the financial position of Lakeland Electric or the results of their operations.

NOTE W - COMMITMENTS AND CONTINGENCIES

Self-Insurance Program:

The City has established a self-insurance fund for worker's compensation, general liability, public official's liability, airport liability, automobile liability, and health insurance. The purpose of this fund is to account for the cost of claims and management fees incurred in conjunction with self-insurance programs. The City makes contributions to the fund based on actuarially computed funding levels. The funding level for Lakeland Electric is determined actuarially based on Lakeland Electric's share of the total City budget, number of vehicles owned and rented, number of employees and payroll. Contributions in excess of these funding levels are accounted for as residual equity transfers in the paying fund. All claims pending at September 30, 2006, have been accrued in the financial statements of the Self-Insurance Fund. An estimated liability for incurred-but-not-reported claims also has been accrued in the financial statements of the Self-Insurance Fund.

NOTE W - COMMITMENTS AND CONTINGENCIES (CONTINUED)

This program provides coverage up to a maximum of $400,000 per employee for worker's compensation claims. The City purchases commercial insurance for claims in excess of this amount up to $1,000,000 per employee. The program provides coverage of up to a maximum of $150,000 per employee for health insurance claims. The City purchases commercial insurance for claims in excess of this amount up to $1,000,000 per employee. For additional disclosures, refer to the City of Lakeland, Florida Comprehensive Annual Financial Report.

Contractual Commitments:

Lakeland Electric has contracts for the purchase and delivery of coal requiring the purchase of a minimum number of tons per year.

Lakeland Electric also has contracts for the supply and transportation of natural gas requiring the purchase and transportation of a minimum and a maximum number of cubic feet of natural gas per year.

Lakeland Electric has contracts for the purchase/sale and delivery of electric energy setting a maximum number of megawatts available for purchase.

Since 1996, Lakeland Electric has entered into contracts with eighteen major customers to provide their electric energy requirements. As of September 30, 2006, there were ten major customers with twenty-four accounts.

Lakeland Electric has a long term service agreement with Siemens/Westinghouse to provide labor, parts, and materials to cover all planned outages for McIntosh Unit 5, a 350 megawatt combined cycle gas turbine unit. The annual cost is based on a combination of the number of hours the unit operates and the number of equivalent starts experienced. The City renegotiated the contract with Siemens/Westinghouse during fiscal year 2005 and it runs through fiscal year 2011. Annual payments, the majority of which will ultimately be capitalized as replacement parts, are scheduled as follows:

Fiscal Year	Amount
2007	$ 4,111,120
2008	$ 5,168,400
2009	$ 5,254,540
2010	$ 5,340,680
2011	$ 4,680,900

In 2000, Lakeland Electric entered into a contract with the Florida Municipal Power Association (FMPA) that allows the FMPA the option of taking up to 100 megawatts of energy per hour at a fixed cost. Significant increases in fuel costs have resulted in substantial losses to Lakeland Electric under this contract. Lakeland Electric currently has hedged 85% of the estimated natural gas required to service the remainder of the contract at price of $8.14 per mmbtu. Future losses from the contract could possibly be high. The future losses thru the termination date of the contract are currently estimated at $28 million. These future losses will absorbed in part thru continuing reductions in operating and maintenance expenses and continuing reductions in the transfer paid to the City's General Fund. The contract originally ran through December 15, 2010. During fiscal year 2004, management negotiated with the FMPA to reduce the length of the contract by three years so that it now runs through December 15, 2007.

It is management's opinion that they are in compliance with the requirements of all the aforementioned contracts.

Disaster Recovery:

On October 21, 2005, Hurricane Wilma struck the State of Florida causing significant damage. Affected counties within the State of Florida were declared a major disaster by the President. Although the Lakeland area received no substantial damage from Hurricane Wilma, Lakeland Electric incurred costs of $75,238 related to emergency protective measures, of which the Federal Emergency Management Agency (FEMA) provided $56,328 in disaster assistance through grants passed through the State of Florida Department of Community Affairs. All reimbursable expenditures were received as of September 30, 2006.

NOTE X - SUBSEQUENT EVENTS

Natural gas commodity swap:

Lakeland Electric City hedges its' exposure to fluctuations in the price of natural gas by purchasing natural gas futures contracts on the New York Mercantile Exchange (NYMEX) and using natural gas commodity swaps with a financial institution and a gas supplier. The majority of these hedge transactions mature with a period of 30 months from balance sheet date.

Lakeland Electric follows the guidance of FAS 80 with respect to accounting for futures contracts acquired through the NYMEX. Per the terms of that accounting guidance, these contracts qualify as "effective hedges" and as a result, the change in the market value of these instruments is not recognized as a gain or loss in the accounting period in which the change occurs. Any change in the market value is deferred until the period in which the contract is settled.

Lakeland Electric follows the guidance of GASB Technical Bulletin 2003-1 with respect to accounting for hedge transactions entered into using commodity swaps. Accordingly, any change in the market value of these hedges is also deferred until the account period in which the swap transaction is ultimately settled.

As of September 30, 2006, the Lakeland Electric held futures contracts purchased with NYMEX having a negative market value of approximately $27 million. That change in market value, in addition to the initial margin requirements of NYMEX resulted in a combined cash balance in the City's margin account that exceeded $40 million. The decline in market value of those positions was not recognized on the face of the financial statements in accordance with the provisions of FAS 80 as described.

Lakeland Electric participates in a pooled cash and investments fund with various other funds of the City. To offset the impact of the margin deposit requirements on working capital as of September 30, 2006, the City recorded a temporary cash transfer to the Electric Utility Fund equal to the balance in the NYMEX margin account of $40,994,035. The source of this temporary cash transfer was the unrestricted cash balances in various other funds of the City that participate along with the Electric Utility Fund in the pooled cash and investments program. This cash transfer was offset by an internal due to / due from on the balance sheets of the affected funds above (see "interest swaps", included in Note M).

On November 3, 2006, Lakeland Electric entered into a transaction in which all of its outstanding futures contracts on NYMEX were electronically transferred to the NYMEX accounts of J Aron & Company, a financial institution that the City uses to hedge natural gas prices using commodity swaps. Simultaneously, the City entered into a commodity swap with J Aron & Company that consists of notional amount, maturity dates, and unit prices that equal the quantities, maturity dates and prices that will be electronically transferred to the swap provider from its account on NYMEX.

As a result of this transaction, Lakeland Electric closed its margin account on NYMEX, and was refunded all of its margin account balance, less a commodity pricing spread equal to 4 cents per mmbtu, or $505,600. The proceeds of that transaction along with other available cash of the utility were used to immediately settle the interfund due to / due from.

As a result of this transaction, the Utility was left with the same portfolio of natural gas hedges after this transaction (in the form of commodity swaps) as it held in natural gas hedges on NYMEX immediately prior to the transaction. Per the accounting guidance of both FAS 80 and GASB Technical Bulletin 2003-1, any gain or loss on hedging transactions is deferred until the underlying financial instruments mature, regardless of whether those hedges take the form of NYMEX futures or commodity swaps.

However, because the commodity swap transaction represented a trade at prices that were above the current market prices, J Aron & Company was required to make a cash outlay to take over the City's positions on NYMEX. A portion of the 4 cents per mmbtu spread paid by the City to J Aron represents embedded financing costs of that transaction. The fee paid to J Aron & Company has been capitalized on the balance sheet of the Electric Utility Fund and will be amortized over the remaining term of the underlying commodity swaps.

NOTE X - SUBSEQUENT EVENTS (CONTINUED)

Natural gas commodity swap (continued):

The Statement of Cash flows for the fiscal year ending September 30, 2007, will show a source of cash, disclosed as an operating activity, equal to the cash value of the amount removed from the margin account on NYMEX and simultaneously deposited into the unrestricted cash and cash equivalents account of Lakeland Electric. That portion of the transaction which represents the embedded financing cost will appear on the statement of cash flows as a use of funds, classified as an investing activity.

Bond warrant financing agreement:

On January 16, 2007, the City of Lakeland entered into a Bond Warrant Agreement with an underwriter, Goldman, Sachs & Co, in which the City granted an irrevocable option to the underwriter which, if exercised, would cause the City of Lakeland to issue parity revenue bonds of the Energy System in the amount of approximately $158,600,000. The new bonds would be issued at terms and fixed interest rates that would generate an annual debt service requirement that equals the annual debt service requirement on the existing Energy System Revenue bonds Series 1999A. If the option is exercised, the bonds would be issued with effective dates of either October 1, 2009; October 1, 2010; October 1, 2011; or October 1, 2012 at the discretion of the underwriter.

In exchange for granting this option, the underwriter made a single, up-front payment of $7,680,000 to the City of Lakeland. Should the underwriter exercise their option under this agreement, the City can use the proceeds of the new bond issue to either call the Series 1999A bonds (which are callable any time after October 1, 2009) or use the proceeds to finance qualified capital improvements projects of the Electric Utility System. The economics of the transaction are equivalent to the refunding the issue at a weighted average yield of approximately 4.25 percent, which approximates the MMD yield curve plus 13 basis points.

Lakeland Electric will recognize the proceeds of this transaction on the balance sheet as a deferred credit. To the extent the underwriter exercises the option to require issuance of new bonds, the deferred credit will be amortized on Lakeland Electric’s income statement over the life of the new bond issue. The underwriter may exercise their option anytime between the dates of August 1, 2009, and August 1, 2012. In the event the underwriter does not exercise that option, the deferred credit will be amortized to the income statement in it’s entirety in the fiscal year ending September 30, 2012.

McIntosh Unit 5 settlement agreement:

During a routine maintenance outage of McIntosh Unit 5 during November 2006, rust was discovered on the generator’s turbine blades. The problem was associated with moisture in the turbine casing resulting in scale or oxidation that comes loose during generator start-up after outage events. McIntosh Unit 5 was expected to be off-line until February or March 2007. Lakeland Electric has been negotiating a settlement agreement with Siemens/Westinghouse, the generator’s manufacturer, relative to turbine blade failure and other issues in general. As part of the settlement, Siemens/Westinghouse has tentatively agreed to confer benefits to Lakeland Electric in the aggregate amount of $9,470,000. Included in the tentative settlement was a $1,700,000 credit against the fiscal year 2007 long term service agreement payment representing incremental purchased power costs during the outage caused by the blade failure.