

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

FINANCIAL STATEMENTS

SEPTEMBER 30, 2004 AND 2003

CONTENTS

INDEPENDENT AUDITORS' REPORTS	1
MANAGEMENT'S DISCUSSION AND ANALYSIS	3
FINANCIAL STATEMENTS	
Balance Sheets	8
Statements of Revenues, Expenses and Changes in Net Assets	9
Statements of Cash Flows	10
Notes to Financial Statements	11

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 (Lakeland Electric) of the City of Lakeland, Florida, as of September 30, 2004 and 2003, 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, 2004 and 2003, 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.

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, 2004 and 2003, 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.

The *Management's Discussion and Analysis* on pages 4 through 7 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. 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 21, 2005
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, 2004. 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 summarize the financial condition and operations of Lakeland Electric for the years ended September 30, 2004 and 2003 respectively:

	(In Thousands)	
	September 30	
	2004	2003
<u>Assets</u>		
Utility plant, net	\$ 624,334	\$ 632,660
Current assets	82,693	76,686
Restricted assets	7,635	33,572
Other noncurrent assets	131,441	104,826
	<u>\$ 846,103</u>	<u>\$ 847,744</u>
<u>Liabilities and Net Assets</u>		
Long-term debt	\$ 484,306	\$ 495,396
Current liabilities	26,955	20,892
Current liabilities not payable from current assets	40,316	30,868
Other noncurrent liabilities	16,203	14,194
Net assets invested in capital assets, net of related debt	147,835	173,182
Unrestricted net assets	130,488	113,212
	<u>\$ 846,103</u>	<u>\$ 847,744</u>
<u>Revenues, Expenses and Changes in Net Assets:</u>		
Operating revenues	\$ 298,190	\$ 294,362
Operating expenses	261,289	249,057
Operating income	36,901	45,305
Nonoperating income	2,492	2,172
Nonoperating expenses	(26,460)	(26,063)
Income before transfers	12,933	21,414
Transfers	(21,004)	(20,940)
Change in net assets	(8,071)	474
Net assets, beginning of year (as restated)	286,394	289,911
Cumulative effect of change in accounting principle	-	(3,991)
Net assets, end of year	<u>\$ 278,323</u>	<u>\$ 286,394</u>

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.

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

Management's Discussion and Analysis (Continued)

Financial Highlights

- Deferred Regulatory Charges of \$6.0 million are included in Lakeland Electric's current assets. This represents the cumulative "under recovery" of fuel costs from retail customers as of September 30, 2004. At the end of the previous fiscal year, the Deferred Regulatory Charges balance as originally reported was \$12.6 million. During fiscal year 2004, Lakeland Electric changed its method of calculating fuel recovery charges to include accrued fuel revenue in the monthly computation. This change, which had the effect of reducing the fuel recovery deficit by \$5.8 million, is further explained in the notes to the financial statements. The Lakeland City Commission authorized fuel adjustment increases during fiscal years 2003 and 2004 in response to the rising fuel costs that contributed to the fuel recovery shortfall.
- As of the end of fiscal year 2003, Lakeland Electric reported \$26.8 million in unspent bond proceeds as part of its restricted cash. The majority of this cash was borrowed for the purpose of constructing a brine concentrator for the generation plants. Lakeland Electric determined that this project was not the most efficient solution to the water treatment issues related to cooling water, and accordingly these borrowed moneys were not expended. During March of 2004, Lakeland Electric completed an analysis of capital spending for the purpose of re-allocating the unspent bond proceeds to eligible capital expenditures. In conjunction with the external bond council, the City documented a re-allocation of these capital expenses to the unspent bond proceeds on hand as of March 9, 2004. The result of this re-allocation is that the remaining unspent funds are not longer considered restricted bond proceeds.
- On May 19, 2004, the City of Lakeland entered into a Standby Bond Purchase Agreement with SunTrust, a Georgia banking corporation. Under the terms of this agreement, SunTrust will provide liquidity support in connection with tenders for purchase of the Series 2001A Bonds. These are variable rate bonds, originally issued in April of 2001 in the aggregate amount of \$90,000,000. These bonds are subject to tender on a weekly basis. Under the terms of this liquidity arrangement, SunTrust is obligated to purchase any bonds of this issue that have been submitted for tender and which cannot be remarketed by the City's remarketing agent, CitiGroup Global Markets, Inc. This liquidity agreement expires May 18, 2009
- During August and September of fiscal year 2004 Lakeland Electric's service territory was adversely affected by hurricanes "Charley", "Frances" and "Jeanne". Through fiscal year 2004, Lakeland Electric spent \$5.1 million on hurricane restoration efforts. At the end of fiscal year 2004, Lakeland Electric also recorded a \$5.8 million liability for estimated accrued incremental costs related to storm restoration. Lakeland Electric expects to receive federal and state disaster recovery funds to cover approximately 85% of the costs incurred through September 30, 2004 as well as 90% of subsequent storm related expenditures. The storm costs have been offset by the estimated recoveries, leaving Lakeland Electric with a net cost of \$1.3 million in fiscal year 2004.

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

Management's Discussion and Analysis (Continued)

Financial Highlights (continued)

- Operating revenues increased by \$3.8 million from the previous year. This is mainly the result a \$24.4 million increase in retail fuel revenues, a \$19.2 million decrease in wholesale sales, and a slight (.5%) decrease in retail energy consumption.
- Fuel and purchased power expenses increased by \$9.7 million from the previous fiscal year in spite of the overall reduction in both retail consumption and wholesale sales. The average price of coal and natural gas burned in fiscal year 2004 increased by an average of 6% and 7% respectively over the previous year. Purchased power costs increased by 96% from the previous fiscal year largely due to unscheduled maintenance outages of Lakeland Electric's two primary generation units. Non-fuel operating expenses decreased by \$0.2 million from the previous year. This was primarily the result of cost containment efforts; a \$0.8 million decrease in the pension funding requirement; and net cost reductions in the final quarter as a result of the necessity to direct efforts toward hurricane restoration projects, which were reimbursable from state and federal disaster recovery funds.

Capital Assets

The following table contains a summary of the utility plant investment net of accumulated depreciation as of the September 30, 2004 and 2003:

	(In Thousands)	
	September 30	
	2004	2003
Land	\$ 11,082	\$ 9,454
Construction in process	27,384	27,608
Buildings	21,751	19,083
Machinery and equipment	22,380	23,795
Electric transmission and distribution	212,403	215,197
Electric plants in service	329,334	337,523
	<u>\$ 624,334</u>	<u>\$ 632,660</u>

During recent fiscal years, Lakeland Electric placed significant plant assets into service, including a 360 megawatt combined cycle unit and a 50 megawatt peaking facility. Lakeland Electric has sufficient generation and transmission capacity to cover its projected load requirements for the next eight to ten years. As can be seen in the above schedule, there was a net decrease in fixed assets during fiscal year 2004 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.

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

Management's Discussion and Analysis (Continued)

Debt

At September 30, 2004, Lakeland Electric had \$484.3 million in net long-term debt outstanding compared to \$495.4 million at the end of 2003 as shown in the following table:

	(In Thousands)	
	September 30	
	2004	2003
Electric System Revenue Bonds:		
Series 1999A	\$ 194,180	\$ 194,565
Series 1999B	94,165	105,525
Series 1999C	64,525	64,525
Series 2001A	90,000	90,000
Series 2001B	30,000	30,000
Series 2003	47,860	47,860
	<u>520,730</u>	<u>532,475</u>
Less current portion	(13,250)	(11,745)
Less unamortized loss on refunding	(24,677)	(27,185)
Unamortized bond discount (net of premium)	1,503	1,851
	<u>\$ 484,306</u>	<u>\$ 495,396</u>

*Series 1999A Electric and Water Refunding Bonds includes Electric portion only.

Economic Factors

Lakeland Electric expects to see continued growth in retail revenue with an anticipated increase in the customer base of about 2%. The growth in revenue, along with cost control measures and timely rate relief as necessary to address any significant future fuel cost increases, should allow Lakeland Electric to continue to show bond coverage from operations of over 2 times.

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 Megawatts 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 losses under the contract. The total loss on the contract for the fiscal year 2004, including all fuel and variable O&M expenses, and including the capacity revenues associated with the contract was \$7.3 million. The comparable fiscal year 2003 loss was \$6.1 million. Because the under-recovery of fuel on the FMPA contract is not being passed along to retail customers as a component of the fuel charge; these losses are being absorbed by the utility. During fiscal year 2004 Lakeland Electric negotiated with FMPA to shorten the contract by three years from December 2010 to December 2007. The negotiated settlement also calls for the non-binding scheduling of the FMPA's monthly requirements under the contract in order for Lakeland Electric to better manage its resources.

LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

Management's Discussion and Analysis (Continued)

Economic Factors (continued)

A continued upward trend in fuel costs (natural gas, coal, oil and petroleum coke) can be expected, with the possibility of significant fluctuations in oil and natural gas. Lakeland Electric is making further efforts to manage this risk by expanding its fuel hedging program. A consulting firm was hired during fiscal year 2003 to provide additional expertise in managing natural gas costs. During fiscal year 2004, the fuel hedging program met the overall established objectives of the Risk Oversight Committee, which was formed by Management, to monitor the fuel hedging program.

Request 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 the 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	
	2004	2003
<u>ASSETS</u>		
UTILITY PLANT:		
Utility plant in service	\$ 991,261,303	\$ 977,582,785
Less accumulated depreciation	394,311,397	372,530,922
	596,949,906	605,051,863
Construction in progress	27,384,300	27,607,910
Total utility plant	624,334,206	632,659,773
CURRENT ASSETS:		
Cash and cash equivalents	7,487,036	1,128,697
Accounts receivable	43,928,704	42,056,129
Less allowance for uncollectibles	(938,597)	(913,655)
Inventories	26,149,478	26,546,702
Deferred regulatory charges	6,035,021	6,809,113
Other current assets	31,679	1,058,626
Total current assets	82,693,321	76,685,612
RESTRICTED ASSETS	7,634,775	33,572,299
DESIGNATED ASSETS	122,609,027	96,613,406
OTHER ASSETS	8,831,477	8,212,503
TOTALS	\$ 846,102,806	\$ 847,743,593
<u>LIABILITIES</u>		
LONG-TERM DEBT, less current portion	\$ 484,305,626	\$ 495,396,547
ACCRUED LIABILITIES, less current portion	15,241,240	13,094,002
ADVANCES FROM OTHER FUNDS, less current portion	962,311	1,099,784
	500,509,177	509,590,333
CURRENT LIABILITIES, payable from current assets:		
Accounts payable	23,946,872	18,030,489
Accrued liabilities	2,871,098	2,724,097
Due to other funds	137,473	137,473
Total current liabilities, payable from current assets	26,955,443	20,892,059
DESIGNATED LIABILITIES	32,680,188	24,073,665
RESTRICTED LIABILITIES	7,634,775	6,793,408
Total liabilities	567,779,583	561,349,465
<u>NET ASSETS</u>		
Invested in capital assets, net of related debt	147,835,534	173,181,567
Unrestricted	130,487,689	113,212,561
Total net assets	278,323,223	286,394,128
TOTALS	\$ 846,102,806	\$ 847,743,593

See accompanying notes to financial statements

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	<u>Year ended September 30</u>	
	<u>2004</u>	<u>2003</u>
OPERATING REVENUES:		
Sales, electricity	\$ 291,415,806	\$ 286,876,694
Other electric operating revenue	6,773,883	7,485,561
Total operating revenues	<u>298,189,689</u>	<u>294,362,255</u>
OPERATING EXPENSES:		
Fuel and purchased power	153,875,784	144,163,874
Energy supply	26,648,202	26,670,502
Energy delivery	17,309,511	17,533,197
Customer service	9,056,497	8,442,818
State tax on electric sales	6,417,328	5,759,162
Administrative and general	14,088,184	15,301,628
Total operating expenses	<u>227,395,506</u>	<u>217,871,181</u>
OPERATING INCOME BEFORE DEPRECIATION	70,794,183	76,491,074
Less depreciation	<u>33,893,038</u>	<u>31,185,680</u>
OPERATING INCOME	<u>36,901,145</u>	<u>45,305,394</u>
NONOPERATING REVENUES (EXPENSES):		
Investment revenue (less \$157,131 and \$425,325 capitalized in 2004 and 2003, respectively)	2,033,743	2,447,192
Net decrease in the fair value of cash equivalents	(184,823)	(880,762)
Miscellaneous revenue	643,396	605,556
Interest expense and fiscal charges (less \$608,568, and \$763,911 capitalized in 2004 and 2003, respectively)	(23,039,482)	(23,925,296)
Amortization expense	(2,465,064)	(2,137,112)
Loss on disposal of fixed assets	(955,911)	-
	<u>(23,968,141)</u>	<u>(23,890,422)</u>
INCOME BEFORE TRANSFERS	12,933,004	21,414,972
TRANSFERS TO OTHER FUNDS	<u>(21,003,909)</u>	<u>(20,940,707)</u>
CHANGE IN NET ASSETS	(8,070,905)	474,265
NET ASSETS, beginning of year	286,394,128	289,911,076
Cumulative effect of change in accounting principle	-	(3,991,213)
NET ASSETS, end of year	<u>\$ 278,323,223</u>	<u>\$ 286,394,128</u>

See accompanying notes to financial statements

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

STATEMENTS OF CASH FLOWS

	Year ended September 30	
	2004	2003
Cash flows from operating activities:		
Receipts from customers	\$ 296,204,288	\$ 298,504,206
Payments to suppliers	(187,004,870)	(185,698,674)
Payments to employees	(30,806,078)	(31,179,898)
Net cash provided by operating activities	78,393,340	81,625,634
Cash flows used in noncapital financing activities:		
Increase in meter deposits payable, net	846,099	568,512
Operating transfers to other funds	(21,003,909)	(20,940,707)
Cash flows used in noncapital financing activities	(20,157,810)	(20,372,195)
Cash flows used in capital financing activities:		
Interest paid on long-term debt issued to finance capital assets	(23,900,435)	(29,634,241)
Proceeds from issuance of long-term debt	-	47,860,000
Net issuance / repayment of interfund loans	(132,332)	1,165,303
Payments on and maturities of long-term debt	(11,745,000)	(54,375,000)
Purchase of capital assets	(28,118,427)	(43,228,843)
Cash flows used in capital financing activities:	(63,896,194)	(78,212,781)
Cash flows provided by investing activities:		
Investment revenue	2,033,743	2,447,192
Net decrease in the fair value of cash equivalents	(184,823)	(880,762)
Cash flows provided by investing activities	1,848,920	1,566,430
Net decrease in cash and cash equivalents	(3,811,744)	(15,392,912)
Cash and cash equivalents, beginning of year	116,836,331	132,229,243
Cash and cash equivalents, end of year	\$ 113,024,587	\$ 116,836,331
Adjustments to reconcile operating income to net cash provided by operating activities:		
Operating income	\$ 36,901,145	\$ 45,305,394
Depreciation	33,893,038	31,185,680
Miscellaneous revenue	643,396	605,556
Decrease (increase) in receivables, net	(2,628,797)	4,409,377
Decrease in inventory	397,224	3,048,342
Decrease in other current assets	1,026,947	4,702,595
Decrease (increase) in deferred regulatory charges	774,093	(11,673,310)
Decrease (increase) in net pension obligation	(824,328)	1,349,347
Increase in accounts payable	5,916,383	296,398
Increase in accrued liabilities	2,294,239	2,396,255
Net cash provided by operating activities	\$ 78,393,340	\$ 81,625,634

See accompanying notes to financial statements

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

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 has adopted the uniform system of accounts prescribed by the Federal Energy Regulatory Commission for electric operations. 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 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 the utility 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, 2004 and 2003, respectively.

Inventories:

Inventories 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.

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.

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.

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

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.

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 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:

	<u>Year Ended September 30</u>	
	<u>2004</u>	<u>2003</u>
Annual dividend to the City of Lakeland	\$ 15,615,594	\$ 15,525,000
Transfers to city funds for electric service	5,257,974	4,863,080
Transfers to Public Improvement for fixed assets	130,341	343,726
Transfer to Fleet Management Fund for new vehicles	-	208,901
	<u>\$ 21,003,909</u>	<u>\$ 20,940,707</u>

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.

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 P – Derivatives and Hedging Activities. Debt related derivative information is included in Note K – Revenue Bonds.

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

NOTE A -SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Reclassification:

For comparability, certain 2003 amounts have been reclassified to conform to the financial statement presentation for 2004.

Other Significant Accounting Policies:

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

NOTE B – CHANGE IN ACCOUNTING POLICY

During 2004, the Lakeland City Commission authorized a policy change for calculating deferred regulatory charges. In fiscal years prior to 2004, the retail portion of Lakeland Electric's deferred regulatory charges calculation was based on billed energy consumption, and excluded accrued retail energy sales. Under the revised policy, the fuel component of accrued retail sales is included in the calculation. The beginning net asset balance as previously reported for the year ending September 30, 2003 has been restated based on the cumulative effect of the change in policy as follows:

Net Assets, September 30, 2003, as previously reported	\$ 292,236,746
Overstatement of revenues in fiscal year 2003	(1,851,405)
Cumulative effect of years prior to fiscal year 2003	<u>(3,991,213)</u>
Net Assets, September 30, 2003, as restated	<u>\$ 286,394,128</u>

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.

Cash Equivalents and Investments:

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 direct 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.

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

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

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.

The investments held as of September 30, 2004 and 2003 are classified according to type of credit risk. These credit risk categories are defined as follows:

Category A - Insured or registered securities held by Lakeland Electric or their agents in Lakeland Electric's name.

Category B - Uninsured and unregistered securities held by the counterparty's trust department or agent in Lakeland Electric's name.

Category C - Uninsured and unregistered securities held by the counterparty or by its trust department or agent, but not in Lakeland Electric's name.

These broad categories do not apply to all types of investments owned by Lakeland Electric. The investments with the Florida State Board of Administration are not categorized because they are not evidenced by securities that exist in physical or book entry form.

The carrying amount of Lakeland Electric's demand and time deposits with financial institutions as of September 30, 2004 was \$18,891,396. In addition, Lakeland Electric's cash and cash equivalents balance includes an index margin account, used for fuel hedging, with a market value of \$695,133 as of September 30, 2004.

No Cash Equivalents and Investments were held directly by Lakeland Electric as of September 30, 2004.

Cash Equivalents and Investments held directly by Lakeland Electric as of September 30, 2003 are as follows:

	Interest Rate %	Maturing Through	Reported Amount Fair Value
Uncategorized:			
Florida State Board of Administration	(1)	(1)	\$ 25,995,821

(1) Funds are invested in the Florida State Board of Administration's local government pooled investment account. The rate of interest fluctuates daily. The interest rate on September 30, 2004 and 2003 was 1.64% and 1.30%, respectively.

EQUITY IN POOLED INVESTMENTS:

Information regarding credit risk categories for pooled investments is disclosed in the comprehensive annual financial report for the City.

As of September 30, 2004 and 2003, the fair value of the total investment pool and Lakeland Electric's share of the pool was as follows:

	Reported Amount Fair Value
<u>As of September 30, 2004:</u>	
Total Investment Pool	\$ 245,944,234
Lakeland Electric's Share of the Investment Pool	\$ 93,438,058
<u>As of September 30, 2003:</u>	
Total Investment Pool	\$ 243,561,233
Lakeland Electric's Share of the Investment Pool	\$ 88,514,157

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

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

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

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

	September 30	
	2004	2003
Current assets:		
Cash and cash equivalents	\$ 7,487,036	\$ 1,128,697
Designated assets:		
Cash and cash equivalents	97,902,776	82,135,335
Restricted assets		
Cash and cash equivalents	7,634,775	33,572,299
	\$ 113,024,587	\$ 116,836,331

NOTE D - INVENTORIES

The major classes of inventory consist of the following:

	September 30	
	2004	2003
Fuel oil	\$ 3,611,252	\$ 5,306,509
Coal	4,709,781	3,822,050
Spare parts	17,828,445	17,418,143
	\$ 26,149,478	\$ 26,546,702

NOTE E - RESTRICTED ASSETS

The revenue bond ordinances and certain other agreements require the restriction of certain assets for specific purposes. Restricted assets and current liabilities payable from restricted assets in Lakeland Electric as of September 30, 2004 and 2003 consist of the following:

	Bond Proceeds	Customer Deposits	Total Restricted
<u>September 30, 2004:</u>			
Cash and cash equivalents	\$ -	\$ 7,634,775	\$ 7,634,775
Meter deposits payable	\$ -	\$ 7,629,875	\$ 7,629,875
Accrued interest payable	-	4,900	4,900
Current liabilities, payable from restricted assets	\$ -	\$ 7,634,775	\$ 7,634,775
	Bond Proceeds	Customer Deposits	Total Restricted
<u>September 30, 2003:</u>			
Cash and cash equivalents	\$ 26,778,891	\$ 6,793,408	\$ 33,572,299
Meter deposits payable	\$ -	\$ 6,783,776	\$ 6,783,776
Accrued interest payable	-	9,632	9,632
Current liabilities, payable from restricted assets	\$ -	\$ 6,793,408	\$ 6,793,408

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

NOTE F - DESIGNATED ASSETS

The City of Lakeland and Lakeland Electric have established long range plans concerning the utility. 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 set aside monthly and designated for that purpose, even though there is no longer a legal requirement to do so.

Designated assets of Lakeland Electric consists of the following:

	Debt Service Funds	Capital Expansion	Emergency Repair	Total Designated
Cash and cash equivalents	\$ 460,953	\$ 68,039,337	\$ 6,838,051	\$ 75,338,341
Cash with paying agent/trustee	22,564,435	-	-	22,564,435
Accounts receivable	-	1,428,283	264,750	1,693,033
Due from other governments	-	-	9,559,061	9,559,061
Advances to other funds	13,454,157	-	-	13,454,157
Designated assets	<u>\$ 36,479,545</u>	<u>\$ 69,467,620</u>	<u>\$ 16,661,862</u>	<u>\$ 122,609,027</u>
Current portion of revenue bonds payable	\$ 13,250,000	\$ -	-	\$ 13,250,000
Accounts payable	125,085	492,736	2,815,760	3,433,581
Accrued expenses	-	124,454	6,354,210	6,478,664
Accrued interest payable	9,517,943	-	-	9,517,943
Liabilities payable from designated assets	<u>\$ 22,893,028</u>	<u>\$ 617,190</u>	<u>\$ 9,169,970</u>	<u>\$ 32,680,188</u>
September 30, 2003:				
	Debt Service Funds	Capital Expansion	Emergency Repair	Total Designated
Cash and cash equivalents	\$ 255,222	\$ 51,671,602	\$ 8,419,743	\$ 60,346,567
Cash with paying agent/trustee	21,788,768	-	-	21,788,768
Accounts receivable	-	1,018,774	-	1,018,774
Due from other governments	13,459,297	-	-	13,459,297
Designated assets	<u>\$ 35,503,287</u>	<u>\$ 52,690,376</u>	<u>\$ 8,419,743</u>	<u>\$ 96,613,406</u>
Current portion of revenue bonds payable	\$ 11,745,000	\$ -	\$ -	\$ 11,745,000
Accounts payable	25,458	1,732,453	-	1,757,911
Accrued expenses	-	297,225	-	297,225
Accrued interest payable	10,273,529	-	-	10,273,529
Liabilities payable from designated assets	<u>\$ 22,043,987</u>	<u>\$ 2,029,678</u>	<u>\$ -</u>	<u>\$ 24,073,665</u>

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

NOTE G - OTHER ASSETS

Other Assets consist of the following:

	September 30	
	2004	2003
Unamortized bond issue cost	\$ 5,300,747	\$ 5,506,100
Net pension obligation (assets)	3,530,730	2,706,403
	\$ 8,831,477	\$ 8,212,503

NOTE H - UTILITY PLANT

Utility plant consists of the following:

	September 30, 2003	Additions	Deletions	September 30, 2004
Non-Depreciable Assets:				
Land	\$ 9,454,342	\$ 1,659,638	\$ 32,226	\$ 11,081,754
Construction in process	27,607,910	22,763,370	22,986,980	27,384,300
Depreciable Assets:				
Buildings	26,818,394	3,366,122	-	30,184,516
Machinery and equipment	37,893,006	2,633,881	905,387	39,621,500
Electric transmission and distribution	323,052,713	7,062,055	11,700,429	318,414,339
Electric plants in service	580,364,330	13,088,446	1,493,582	591,959,194
	1,005,190,695	50,573,512	37,118,604	1,018,645,603
Less accumulated depreciation:				
Buildings	7,735,216	698,175	-	8,433,391
Machinery and equipment	14,098,354	4,465,253	1,322,555	17,241,052
Electric transmission and distribution	107,855,880	8,945,647	10,790,008	106,011,519
Electric plants in service	242,841,472	19,783,963	-	262,625,435
	372,530,922	33,893,038	12,112,563	394,311,397
Total utility plant	\$ 632,659,773	\$ 16,680,474	\$ 25,006,041	\$ 624,334,206

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	
	2004	2003
Amount Capitalized:		
Interest expense	\$ 608,568	\$ 763,911
Less: Interest revenue	157,131	425,325
Net interest capitalized	\$ 451,437	\$ 338,586
Total interest expense	\$ 23,648,050	\$ 24,689,207
Less: Interest expense capitalized	608,568	763,911
Interest expense	\$ 23,039,482	\$ 23,925,296

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

NOTE I - 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% interest and Orlando Utilities Commission a 40% 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 J – LONG-TERM DEBT

Long term debt consists of the following:

	September 30	
	2004	2003
Revenue bonds payable, less current portion	\$ 507,480,409	\$ 520,730,409
Less unamortized loss on refunding	(24,677,209)	(27,185,214)
Plus unamortized bond discount (net of premium)	1,502,426	1,851,352
	\$ 484,305,626	\$ 495,396,547

NOTE K - REVENUE BONDS

Revenue bonds payable as of September 30, 2004:

	Interest Rate %	Final Maturity	September 30, 2003	Additions	Deletions	September 30, 2004
Series 1999A	3.05 to 5.00	10-01-2036	\$ 194,565,409	\$ -	\$ 385,000	\$ 194,180,409
Series 1999B	5.30 to 6.55	10-01-2014	105,525,000	-	11,360,000	94,165,000
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
			\$ 532,475,409	\$ -	\$ 11,745,000	\$ 520,730,409
Less current portion			(11,745,000)			(13,250,000)
			\$ 520,730,409			\$ 507,480,409

Series 1992 bonds and a portion of series 1999A were 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 \$13.3 million, which was offset by an advance (designated asset) to the Water Utility Fund.

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

NOTE K - 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, 2004:

Fiscal Year(s)	Series 1999A Sr.		Series 1999B Sr.	
	Principal	Interest	Principal	Interest
2005	\$ 555,000	\$ 7,864,494	\$ 14,540,000	\$ 5,171,223
2006	575,000	7,842,294	15,585,000	4,218,852
2007	600,000	7,819,293	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
2010-2014	28,214,690	63,727,873	15,310,000	4,218,968
2015-2019	59,020,000	33,392,338	-	-
2020-2024	20,850,000	22,390,250	-	-
2025-2029	26,610,000	16,629,250	-	-
2030-2034	33,960,000	9,278,250	-	-
2035-2039	16,075,000	1,215,500	-	-
	<u>\$ 193,785,409</u>	<u>\$ 189,638,630</u>	<u>\$ 81,310,000</u>	<u>\$ 21,036,823</u>

Fiscal Year(s)	Series 1999C Sr.		Series 2001A Sr.		Series 2001B Sr.	
	Principal	Interest	Principal	Interest*	Principal	Interest
2005	\$ -	\$ 3,903,763	\$ -	\$ 1,350,000	\$ -	\$ 1,561,100
2006	-	3,903,762	-	1,350,000	-	1,561,100
2007	5,095,000	3,903,763	-	1,350,000	-	1,561,100
2008	5,370,000	3,595,515	-	1,350,000	-	1,561,100
2009	5,775,000	3,270,630	-	1,350,000	-	1,561,100
2010-2014	48,285,000	5,986,172	-	6,750,000	12,220,000	7,444,425
2015-2019	-	-	-	6,750,000	17,780,000	2,276,500
2020-2024	-	-	19,275,000	6,329,700	-	-
2025-2029	-	-	28,565,000	4,479,450	-	-
2030-2034	-	-	34,460,000	2,166,975	-	-
2035-2039	-	-	7,700,000	115,500	-	-
	<u>\$ 64,525,000</u>	<u>\$ 24,563,605</u>	<u>\$ 90,000,000</u>	<u>\$ 33,341,625</u>	<u>\$ 30,000,000</u>	<u>\$ 17,526,425</u>

* Interest requirements for Energy System Variable Rate Revenue Bonds are calculated using 110% of the average actual interest rate for the twelve months ending December 31, 2004.

Fiscal Year(s)	Series 2003.		TOTAL		
	Principal	Interest	Principal	Interest	Total
2005	\$ -	\$ 1,789,964	\$ 15,095,000	\$ 21,559,544	\$ 36,654,544
2006	-	1,789,964	16,160,000	20,584,972	36,744,972
2007	-	1,789,964	16,825,000	19,541,155	36,366,155
2008	-	1,789,964	18,000,000	18,479,893	36,479,893
2009	-	1,789,964	25,215,719	21,335,213	46,550,932
2010-2014	-	8,949,820	104,029,690	96,672,258	200,701,948
2015-2019	-	8,949,820	76,800,000	50,963,658	127,763,658
2020-2024	-	8,949,820	40,125,000	37,289,888	77,414,888
2025-2029	-	8,949,820	55,175,000	29,789,753	84,964,753
2030-2034	9,040,000	8,949,820	77,460,000	20,265,027	97,725,027
2035-2039	38,820,000	3,290,640	62,595,000	4,614,710	67,209,710
	<u>\$ 47,860,000</u>	<u>\$ 56,989,560</u>	<u>\$ 507,480,409</u>	<u>\$ 341,096,071</u>	<u>\$ 848,576,480</u>

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

NOTE K - 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 2004 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
2004	\$ 73,286,499	\$ 13,250,000	\$ 22,416,570	\$ 35,666,570	2.05	2.95
2003	83,203,722	11,745,000	23,940,421	35,685,421	2.33	3.03
2002	74,687,403	12,550,000	25,037,914	37,587,914	1.99	2.82
2001	86,077,891	10,085,000	25,657,600	35,742,600	2.41	3.22
2000	91,543,249	9,520,000	22,392,786	31,912,786	2.87	3.65
1999	94,483,488	8,335,000	23,700,881	32,035,881	2.95	3.79

Bond debt coverage for the year ended September 30, 2004 was calculated as follows:

Charges for services	\$ 298,189,689	
Investment and other income	2,492,316	
Total revenue		\$ 300,682,005
Less cost of operations		<u>(227,395,506)</u>
Net revenues from operations available for debt service		73,286,499
Fund balance (as defined by bond ordinance):		
Cash and equivalents	\$ 7,487,036	
Accounts receivable (net of uncollectables)	42,990,107	
Designated assets:		
Cash and cash equivalents	97,902,776	
Receivables	1,693,033	
Due from other governments	9,559,061	
	<u>\$ 159,632,013</u>	
20% of fund balance		31,926,403
Net available revenues plus 20% of fund balance		<u>\$ 105,212,902</u>
Debt service requirement:		
Interest	\$ 22,416,570	
Principal	13,250,000	
Total	<u>\$ 35,666,570</u>	
Bond coverage		<u>2.95</u>
Bond coverage from operations		<u>2.05</u>

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, 2004 all funds and accounts required by the bond ordinance were being maintained in conformance with the ordinance.

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

NOTE K - REVENUE BONDS (CONTINUED)

Interest Rate Swaps:

As a means to partially hedge the variable rate risk exposure associated with the issuance of the \$90 million 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 million (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, 2004, the swap had a negative fair value of \$2,321,055, 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, 2004, 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.

As a means 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 \$47.86 million (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 the actual interest rate paid on the underlying 2003 bonds. The agreement calls for an alternate rate to be paid by the counterparty to the City equal to 67 percent of the monthly USD-LIBOR-BBA. The alternate rate prevails whenever the relationship between the BMA Municipal Bond Index and the monthly USD-LIBOR-BBA exceeds 67 percent for a period of more than the preceding 180 days. The alternate rate also applies in the event of default on the bonds by the City, a downgrade in ratings issued by S&P or Moody's, conversion of the variable interest rate terms on the underlying bonds to other than a weekly mode, or whenever the City is required to draw on the liquidity facility established on the underlying bonds.

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 approximately .35 percent for liquidity and remarketing fees on the underlying variable rate issue. The notional amount of the swap will always equal the amount of the outstanding principal on the underlying bonds, which mature serially from October 2034 thru October 2037. Settlement payments are made monthly. As of September 30, 2004, the swap had a negative fair value of \$2,158,026, 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, 2004, 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. As rates vary, variable rate bond interest payments and net swap payments will vary.

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

NOTE K - REVENUE BONDS (CONTINUED)

Future debt service requirements on the variable-rate debt and net swap payments assuming the then-current bond interest rates (1.46%) and the alternate rate (1.1055%) are as follows:

Ending September 30,	Variable-Rate Bonds		Interest Rate Swaps, Net	Total
	Principal	Interest		
2005	-	\$ 866,266	\$ 1,260,872	\$ 2,127,138
2006	-	866,266	1,260,872	2,127,138
2007	-	866,266	1,260,872	2,127,138
2008	-	866,266	1,260,872	2,127,138
2009	-	866,266	1,260,872	2,127,138
2010-2014	-	4,331,330	6,304,359	10,635,689
2015-2019	-	4,331,330	6,304,359	10,635,689
2020-2024	-	4,331,330	6,304,359	10,635,689
2025-2029	-	4,331,330	6,304,359	10,635,689
2030-2034	9,040,000	4,331,330	6,304,359	19,675,689
2035-2037	38,820,000	1,592,529	2,317,965	42,730,494
	<u>\$ 47,860,000</u>	<u>\$ 27,580,509</u>	<u>\$ 40,144,120</u>	<u>\$ 115,584,629</u>

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 million (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 an interest rate equal to 67 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, 2004, the swap had a negative fair value of \$2,280,184, 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, 2004, 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, bankruptcy, or a rating downgrade by Moody's or S&P issued to either the City or the counterparty.

NOTE L - 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. Prior to October 1, 2003 the required contribution rate was 7% for employees and 12.87% for the City. The actuarial study during fiscal year 2003 indicated a need to increase funding levels. The City Commission has approved increases in the contribution rates to 8% for the employee portion and 14.4% for the City portion. These increases were effective October 1, 2003.

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

NOTE L - EMPLOYEE RETIREMENT SYSTEM (CONTINUED)

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% per year for the first 25 years of service plus 1% 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% 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% of the same average earnings for the next 20 years of credited service, and 1% per year of the same average for each year of service in excess of 30 years.

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 M - 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 N - POST-EMPLOYMENT BENEFITS

In addition to the pension benefits described in Note L, 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.

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

NOTE N - POST-EMPLOYMENT BENEFITS (CONTINUED)

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% was reduced as follows: in fiscal year 2003 to 45%, in fiscal year 2004 to 40%, and in subsequent fiscal years to 35%. 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, 2003 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, 2004, retirees from the Utilities who participated in the plan incurred total costs of \$395,000 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 O - 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% 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 P – 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 (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

Lakeland, uses the New York Mercantile Exchange (NYMEX), natural gas futures contracts, options on futures contracts and index-priced physical purchases of natural gas as tools to establish the cost of natural gas that is included into the cost of natural gas burned in its electric production facilities. At September 30, 2004, Lakeland had the following futures, options, and physical contracts outstanding in the following amounts:

Fiscal Year	Thousands of MMBtu			Mark-to-Market Value at 9/30/04
	Futures	Options	Physicals	
2005	1,060	250	3,979	\$ 4,114,851
2006	-	-	397	141,015
2007	-	-	92	10,880
	<u>1,060</u>	<u>250</u>	<u>4,468</u>	<u>\$ 4,266,746</u>

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

NOTES TO FINANCIAL STATEMENTS
(CONTINUED)

NOTE P – DERIVATIVE AND HEDGING ACTIVITIES (CONTINUED)

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.

The valuation of market changes for Lakeland Electric's Energy Risk Management Program contracts resulted in an increase in fuel expenses of \$115,500 for the fiscal year ending September 30, 2004.

NOTE Q - 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 R - COMMITMENTS AND CONTINGENCIES

Self-Insurance Program:

The City has established a self-insurance fund for worker's compensation, general liability, public officials 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, 2004, 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.

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. Refer to the City of Lakeland, Florida comprehensive annual financial report for additional disclosures.

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 major customers to provide their electric energy requirements.

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

NOTES TO FINANCIAL STATEMENTS
(CONCLUDED)

NOTE R - COMMITMENTS AND CONTINGENCIES (CONTINUED)

In October 1997 Lakeland Electric signed a contract to purchase a 249-megawatt gas-fired generating unit. The gas turbine was placed in service in fiscal year 2001. In fiscal year 2000, Lakeland Electric signed contracts to provide equipment and construction of the conversion of the simple cycle unit into a combined cycle unit with a total output of about 360 megawatts. The combined cycle was placed into service during fiscal year 2002. At the end of fiscal year 2004, both contracts were still open pending completion of outstanding technical issues. The final settlement is expected during fiscal year 2005.

In 2000, Lakeland Electric entered into a contract with the Florida Municipal Power Association (FMPA) that allows 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. 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.

The Department has a contract with Siemens/Westinghouse to provide labor and materials to cover all planned outages based on a specified number of operating hours and starts of the gas turbine mentioned above. At the end of the contract period there will be spare parts with an approximate value of \$6 million that will be turned over to Lakeland Electric. The contract went into effect during fiscal year 2002 and will cover fiscal years through 2005 at an annual cost of \$4.8 million. The City has been in the process of renegotiating with Siemens/Westinghouse on the maintenance contract. Although the final renegotiated settlement is expected to be economically favorable to Lakeland Electric, the actual provisions have not been determined.

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

Disaster Recovery:

On August 13, 2004, Hurricane Charley struck the State of Florida causing significant damage to Lakeland Electric's transmission and distribution facilities. All counties in the State of Florida were declared a major disaster by the President. The disaster declaration provided for up to 100% reimbursement of eligible costs. The Federal Emergency Management Agency (FEMA) will provide disaster assistance through grants passed through the State of Florida Department of Community Affairs. Lakeland Electric expended \$610,000 in hurricane related costs related to Charley, of which \$518,000 is reimbursable. All incurred losses for damages from Charley were significantly repaired as of September 30, 2004.

On September 4, 2004, Hurricane Frances struck the State of Florida causing more damage to Lakeland Electric's transmission and distribution facilities. All counties in the State of Florida were, for the second time, declared a major disaster by the President. The disaster declaration provided for up to 100% reimbursement of eligible costs. The Federal Emergency Management Agency (FEMA) will provide disaster assistance through grants passed through the State of Florida Department of Community Affairs. Lakeland Electric expended \$1.8 million in hurricane related costs related to Frances, of which \$1.6 million is reimbursable. All incurred losses for damages from Frances were significantly repaired as of September 30, 2004.

On September 26, 2004, Hurricane Jeanne struck the State of Florida causing more damage to the City. Affected counties within the State of Florida were again declared a major disaster by the President. The disaster declaration provided for up to 100% reimbursement of eligible costs. The Federal Emergency Management Agency (FEMA) will provide disaster assistance through grants passed through the State of Florida Department of Community Affairs. Lakeland Electric has expended \$2.6 million in hurricane costs related to Jeanne, of which \$2.2 million is reimbursable. In addition, Lakeland Electric has recorded \$5.7 million in expenses offset by \$5.1 million of financial aid recovery for damages that were not repaired as of September 30, 2004.