Department of Electric Utilities

An Enterprise Fund of
the City of Lakeland, Florida

FINANCIAL STATEMENTS

SEPTEMBER 30, 2008 and 2007

LAKELAND ELECTRIC

C O N T E N T S

Crowe Horwath LLP
Member Horwath International

REPORT OF INDEPENDENT AUDITORS

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, (the Department) as of September 30, 2008 and 2007. 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, 2008 and 2007, 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, 2008 and 2007, 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* 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.

Crowe Horwath LLP

Crowe Horwath LLP

March 3, 2009
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, 2008. Readers are encouraged to consider the information presented in this section in conjunction with additional information contained in the financial report. The following condensed Summary of Financial Position and Summary of Revenues, Expenses and Changes in Net Assets summarizes the financial condition and operations of Lakeland Electric for the year ended September 30, 2008 and the previous two fiscal years:

	(In Thousands)		
	September 30		
	2008	2007	2006
Summary of Financial Position			
ASSETS			
Current assets	$ 113,217	$ 122,962	$ 162,085
Utility plant, net	610,085	611,587	605,533
Noncurrent assets	173,055	120,929	113,831
	$ 896,357	$ 855,478	$ 881,449
LIABILITIES AND NET ASSETS			
Current liabilities	$ 24,004	$ 29,365	$ 77,733
Noncurrent liabilities	612,536	572,670	544,596
Net assets invested in capital assets, net of related debt	120,910	130,031	121,402
Unrestricted net assets	138,907	123,412	137,718
	$ 896,357	$ 855,478	$ 881,449
Summary of Revenues, Expenses and Changes in Net Assets			
OPERATING REVENUES			
Sales of energy - retail	$ 354,673	$ 330,153	$ 332,168
Sales of energy and capacity sales - wholesale	22,508	36,899	39,440
Other electric operating revene	7,313	7,519	5,439
	384,494	374,571	377,047
OPERATING EXPENSES			
Fuel and purchased power	218,193	234,334	245,648
Energy supply	21,879	21,409	21,145
Energy delivery	19,638	17,811	16,635
Customer service and accounting	7,795	7,347	7,727
Administrative and general	17,503	14,382	14,264
State tax on electric sales	8,774	8,689	8,342
Depreciation	32,348	37,482	38,712
	326,131	341,454	352,473
OPERATING INCOME	58,363	33,117	24,574
NON-OPERATING ACTIVITY			
Investment and other income	4,540	5,459	4,919
Interest and amortization	(29,431)	(27,653)	(25,784)
Transfers to/from other funds (net)	(23,430)	(16,600)	(18,109)
Loss on impairment of fixed assets	(3,668)	-	-
Plant costs recovered from capital contributions	(1,628)	-	-
Capital contributions	1,628	-	-
	(51,989)	(38,794)	(38,974)
CHANGE IN NET ASSETS	$ 6,375	$ (5,677)	$ (14,400)

Financial Highlights

- Operating revenues for the fiscal year 2008 were $384.5 million, which was an increase of $9.9 million from the previous fiscal year. The non-fuel component of retail revenues increased by $9.8 million from 2007 to 2008 primarily due to an average increase of 10.7 percent in retail base rates, approved by the City Commission in April 2007 and implemented in May 2007. Retail revenues, excluding fuel, averaged $58.42 per 1,000 kilowatt hours (Kwh) during 2008, compared to $54.92 in 2007. Lakeland Electric experienced minimal growth during 2008 in both the residential and the commercial customer base. Wholesale power sales declined by $14.4 million in 2008 with the expiration of a seven year unfavorable contract with the Florida Municipal Power Association (FMPA) in December 2007.

- Lakeland Electric's non-fuel operating expenses (excluding fuel, gross receipts tax, and depreciation) were $66.8 million in fiscal year 2008, a 9.6% increase from $60.9 million in the previous fiscal year. The $5.9 million increase was comprised of the following: other post employment benefits ($2.5 million), payroll costs ($1.1 million), contractual services ($0.7 million), rentals ($0.5 million), bad debt expense ($0.5 million), supplies ($0.4 million), and all other expenses ($0.2 million). The *other post employment benefits (OPEB)* represents an accumulated liability which was recorded for the first time during 2008 in accordance with Governmental Accounting Standard No. 45 (see Note R). Total operating and maintenance costs (excluding fuel, gross receipts tax, and depreciation) averaged $23.16 per 1,000 Kwh in 2008, which was up from $21.09 in 2007.

- The profitability of retail operations (measured before transfers) increased by $0.6 million from the previous fiscal year. The aforementioned base rate increase was in effect during all of 2008, but only the last five months of 2007. The positive effects of the rate increase on retail operations was mostly offset by the increases in operating costs, as well as non-operating items, including a write-down of impaired assets.

- The profitability of wholesale operations increased by $16.7 million from the previous year because of decreased losses associated with the previously mentioned FMPA wholesale power contract (see Economic Factors).

- Fuel and purchased power expenses decreased by $16.1 million, or 6.9 percent from the previous fiscal year primarily because of the reduction in wholesale sales. The average cost of fuel to generate 1,000 Kwh of energy to serve the retail load increased from $60.93 in fiscal year 2007 to $66.86 in fiscal year 2008 because of a 19% average increase in coal prices and an 11% average increase in natural gas prices. Lakeland Electric 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 twelve months. As of September 30, 2008 the retail fuel charge was $72.70 per 1,000 Kwh. Because of a more favorable natural gas market at the end of fiscal year 2008, the fuel charge was reduced to $65.90 per 1,000 on a bills rendered basis effective October 1, 2008.

- Deferred regulatory accounts represent the amount receivable from or payable to retail customers for the cumulative difference between fuel costs incurred to serve retail load and fuel revenues realized. As of September 30, 2008 a *deferred regulatory asset of* $2.2 million was recorded, representing an under-recovery of fuel charges. Comparatively, as of the end of the previous fiscal year, a *deferred regulatory liability of* $2.7 million was included as a current asset because there was an under-recovery of fuel charges.

- Depreciation expense in fiscal year 2008 was $32.3 million, which was $4.9 million lower than in 2007. A depreciation study of Lakeland Electric's transmission and distribution units was completed during fiscal year 2008 resulting in a general increase in the estimated useful lives of those assets and a corresponding reduction of annual depreciation expense by approximately $2.7 million. The change was handled prospectively, and with no effect on prior years. The utility plant in service balance for fiscal year 2007 includes a $14.3 million asset, *negative salvage value*, representing the estimated present value of the future cost to remove existing generation facilities. During fiscal year 2008 a legal opinion concluded that Lakeland Electric is under no future legal obligation to remove abandoned generation facilities. As a result, there is no balance reflected for negative salvage value, or the corresponding liability, *asset retirement obligation*s (see note O) in the Statement of Net Assets for fiscal year 2008. Larsen Unit 7, which was previously retired from service, was sold during fiscal year 2008. The sales proceeds from Unit 7 were slightly more than the cost of removal.

Financial Highlights (Continued)

- An impairment write-down in the amount of $3.7 million was recorded for the former Operations Center, located on Parker Street, because of extensive damage caused by mold and mildew. The estimated cost of mitigating the environmental issues approximated the estimated cost to rebuild. As of September 30, 2008, the only purpose that the Operations Center served was to accommodate the City's telephone switch, which is expected to be retired during fiscal year 2009.

- Lakeland Electric funds the cost of capital improvements through a combination of bond financing and cash generated from retail utility rates. The capital improvements plan prepared by Lakeland Electric projects future spending at an average of approximately $46.5 million over the next 4 years.

- Capital spending for the 2008 fiscal year totaled $48 million compared to $32 in fiscal year 2007 and $21 million in 2006. Lakeland Electric has identified $90 million of EPA compliance and customer growth related capital improvements that are being financed from the proceeds of two bond issues; one issue sold in August 2006, and the second during August 2008.

- Capital contributions (contributions in aid of construction) from outside the City were paid in the amount of $1.6 million during fiscal year 2008.

- Lakeland Electric provides a dividend to the General Fund each year in the form of a cash transfer. The total amount of the dividend in fiscal year 2008 was $23.4 million, representing an increase of $6.8 million from fiscal 2007. This amounted to 6.1 percent of gross operating revenues of Lakeland Electric, which is consistent with the industry median as reported by the American Public Power Association. The lower dividend for 2007 was intended to offset a portion of the losses incurred in conjunction with the FMPA wholesale power contract (see Economic Factors). The dividend for fiscal year 2009 is budgeted at $24 million.

Capital Assets

The following table contains a summary of Lakeland Electric plant investment net of accumulated depreciation as of the September 30, 2008 and 2007:

	(In Thousands)	
	September 30	
	2008	2007
Land	$ 15,613	$ 15,502
Construction in process	50,900	20,929
Buildings	15,204	19,367
Machinery and equipment	15,045	16,937
Electric transmission and distribution	232,260	228,923
Electric plants in service	281,063	309,928
	$ 610,085	$ 611,587

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. Since 2001 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.

Debt

At September 30, 2008, Lakeland Electric had $530.9 million in net long-term debt outstanding compared to $487.4 million at the end of 2007 as shown in the following table. The net increase in outstanding debt is the result of the issuance of additional debt in the amount of $200 million in 2008 – which was used to retire $139.5 million of existing debt and to provide approximately $56.9 million of funding for capital projects. In addition, outstanding debt of $18.8 million was retired on its scheduled maturity date.

	(In Thousands)	
	September 30	
	2008	2007
Electric System Revenue Bonds:		
Series 1999A	$ 192,055	$ 192,655
Series 1999B	40,055	51,185
Series 1999C	59,430	64,525
Series 2001B	30,000	30,000
Series 2006	44,395	44,870
Series 2006 A	-	139,475
Series 2008A	100,000	-
Series 2008B	100,000	-
	565,935	522,710
Less Current Portion	(18,760)	(17,300)
Less unamortized loss on refunding	(16,565)	(17,623)
Unamortized bond discount (net of premium)	298	(402)
	$ 530,908	$ 487,385

Economic Factors

As indicated in Note N, coverage on bonded debt of Lakeland Electric remains very strong at 2.96 times the annual debt service requirement for the fiscal year ended 2008. 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. Removing this aspect of the coverage calculation yields a coverage ratio of 2.14.

In December 2000 Lakeland Electric entered into a contract with the Florida Municipal Power Association (FMPA) that allowed the FMPA the option of taking up to 100 MW of energy per hour at a fixed price. The contract contained a fuel escalation clause that did not kept pace with the rapid increase in natural gas prices, creating significant losses to Lakeland Electric. Because the under-recovery of fuel on the FMPA contract was not passed along to retail customers as a component of the fuel charge, these losses were absorbed by Lakeland Electric. During fiscal year 2004 Lakeland Electric negotiated with FMPA to shorten the length of the contract by three years. The contract expired on December 14, 2007 with a loss, including all fuel and variable O&M expenses, of $5.2 million during the final three months of the contract that is reflected in the results of fiscal year 2008. Comparably, the total loss on the contract for the fiscal year 2007 was $23.8 million.

Significant natural gas and oil price fluctuations have occurred in recent years. Lakeland Electric has created a fuel hedging program that is intended to mitigate fuel price volatility over the near term. The program has historically allowed for the purchase of natural gas using financial and physical contracts for a period of up to twelve months in the future. During fiscal year 2006, this program was expanded to provide for hedging of natural gas prices up to 30 months in advance. Lakeland Electric changed fuel hedging consultants during fiscal year 2007.

Economic Factors (continued)

During fiscal year 2008, the average demand for energy placed on the system from retail customers was approximately 339 MWH, with peak demand during summer of 615 MWH and winter of 684 MWH. Lakeland Electric expects to see an increase in the retail customer base of approximately 1 percent during 2009.

Using This Annual Report

This annual report includes the Statement of Net assets, 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: Manager of Utilities Finance and Accounting, Lakeland Electric, 501 East Lemon St, Lakeland, FL 33801.

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

STATEMENTS OF NET ASSETS

	September 30	
ASSETS	2008	2007
CURRENT ASSETS		
Cash and cash equivalents	$ 28,199,996	$ 19,297,179
Accounts receivable	46,910,525	58,548,975
Less allowance for uncollectibles	(1,260,930)	(1,261,954)
Inventories	29,672,075	38,652,604
Deferred regulatory assets	2,209,839	-
Other current assets	7,485,719	7,724,849
Total current assets	113,217,224	122,961,653
UTILITY PLANT		
Utility plant in service	1,011,145,952	1,074,589,359
Less accumulated depreciation	451,960,685	483,931,133
	559,185,267	590,658,226
Construction in progress	50,899,515	20,929,195
Total utility plant, net	610,084,782	611,587,421
OTHER ASSETS		
Restricted assets	56,452,946	26,292,073
Asset apportionments	106,756,986	87,165,711
Other noncurrent assets	9,845,049	7,471,091
Total other assets	173,054,981	120,928,875
Total Assets	896,356,987	855,477,949
LIABILITIES		
CURRENT LIABILITIES, payable from current assets		
Accounts payable	20,123,681	23,054,529
Accrued liabilities	3,742,452	3,426,278
Due to other funds	137,473	137,473
Deferred regulatory liability	-	2,746,318
Total current liabilities, payable from current assets	24,003,606	29,364,598
OTHER LIABILITIES		
Long-term debt, due beyond twelve months	530,908,147	487,385,362
Accrued liabilities, less current portion	34,041,785	29,131,353
Advances from other funds, less current portion	412,419	549,892
Asset retirement obligations	-	14,275,886
Liabilities payable from apportioned assets, due within twelve months	30,121,013	28,205,643
Restricted liabilities, due within twelve months	17,052,391	13,122,137
Total other liabilities	612,535,755	572,670,273
Total liabilities	636,539,361	602,034,871
NET ASSETS		
Invested in capital assets, net of related debt	120,909,745	130,031,523
Unrestricted	138,907,881	123,411,555
Total net assets	$ 259,817,626	$ 253,443,078

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	
	2008	2007
OPERATING REVENUES		
Sales of energy - retail	$ 354,672,835	$ 330,153,420
Sales of energy and capacity sales - wholesale	22,508,435	36,898,580
Other electric operating revenue	7,312,558	7,518,781
Total operating revenues	384,493,828	374,570,781
OPERATING EXPENSES		
Fuel and purchased power	218,192,524	234,334,085
Energy supply	21,879,079	21,409,438
Energy delivery	19,638,266	17,811,302
Customer service	7,795,171	7,346,642
State tax on electric sales	8,774,419	8,688,739
Administrative and general	17,503,120	14,381,590
Total operating expenses	293,782,579	303,971,796
OPERATING INCOME BEFORE DEPRECIATION	90,711,249	70,598,984
Less depreciation	32,348,107	37,482,304
OPERATING INCOME	58,363,142	33,116,680
NONOPERATING REVENUES (EXPENSES)		
Investment revenue (less $853,975 and $1,022,338 capitalized in 2008 and 2007, respectively)	5,497,745	4,208,904
Net increase (decrease) in the fair value of cash equivalents	(1,718,294)	439,815
Miscelleous revenue	760,655	810,584
Interest expense and fiscal charges (less $1,014,076 and $509,080 capitalized in 2008 and 2007, respectively)	(26,882,575)	(25,150,023)
Amortization expense	(2,548,250)	(2,503,004)
Plant cost recovered through capital contributions	(1,628,236)	-
Loss on impairment of fixed assets	(3,668,075)	-
TOTAL NONOPERATING REVENUES (EXPENSES)	(30,187,030)	(22,193,724)
INCOME BEFORE CAPITAL CONTRIBUTIONS AND TRANSFERS	28,176,112	10,922,956
CAPITAL CONTRIBUTIONS	1,628,236	-
TRANSFERS TO OTHER FUNDS	(23,429,800)	(16,600,000)
CHANGE IN NET ASSETS	6,374,548	(5,677,044)
NET ASSETS, beginning of year	253,443,078	259,120,122
NET ASSETS, end of year	$ 259,817,626	$ 253,443,078

See accompanying notes to financial statements

CITY OF LAKELAND, FLORIDA
DEPARTMENT OF ELECTRIC UTILITIES

STATEMENTS OF CASH FLOWS

	Year ended September 30	
	2008	2007
Cash flows from operating activities:		
Receipts from customers	$ 387,426,620	$ 380,152,619
Withdrawals from natural gas hedge accounts	115,997	41,352,233
Payments for interfund services	(9,376,597)	(9,141,472)
Payments to suppliers	(241,006,918)	(275,725,436)
Payments to employees	(32,197,129)	(31,000,117)
Net cash provided by operating activities	104,961,973	105,637,827
Cash flows used in noncapital financing activities:		
Operating transfers to other funds	(23,429,800)	(16,600,000)
Cash flows used in noncapital financing activities	(23,429,800)	(16,600,000)
Cash flows used in capital and related financing activities:		
Interest paid on long-term debt issued to finance capital assets	(31,240,359)	(24,825,299)
Proceeds from issuance of long-term debt	200,000,000	7,680,000
Proceeds from repayment of interfund loans	30,131	25,107
Payments on interfund loans	(137,473)	(41,131,508)
Payments on and maturities of long-term debt	(156,775,000)	(575,000)
Purchase of capital assets	(44,661,244)	(31,971,847)
Cash flows used in capital and related financing activities:	(32,783,945)	(90,798,547)
Cash flows provided by investing activities:		
Investment transaction costs	-	(482,926)
Investment revenue	6,351,720	5,231,242
Net increase (decrease) in the fair value of cash equivalents	(1,718,294)	442,499
Cash flows provided by investing activities	4,633,426	5,190,815
Net increase in cash and cash equivalents	53,381,654	3,430,095
Cash and cash equivalents, beginning of year	118,553,325	115,123,230
Cash and cash equivalents, end of year	$ 171,934,979	$ 118,553,325
Adjustments to reconcile operating income to net cash provided by operating activities:		
Operating income	$ 58,363,142	$ 33,116,680
Depreciation	32,348,107	37,482,304
Miscellaneous revenue	760,655	810,584
Decrease in receivables, net	6,445,105	489,355
Decrease (increase) in inventory	8,980,529	(8,384,416)
Decrease in other current assets (including prepaid fuel)	239,130	37,678,335
Increase (decrease) in deferred regulatory accounts	(4,956,157)	10,484,267
Decrease (increase) in net pension asset	(197,485)	75,791
Decrease in accounts payable	(2,930,834)	(9,511,244)
Increase in net other post employment benefit obligation	2,446,639	-
Increase in accrued liabilities	2,779,967	1,860,590
Increase in deposits payable	683,175	1,535,581
Net cash provided by operating activities	$ 104,961,973	$ 105,637,827

See accompanying 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 required 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 (FERC) 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 (FAS 71) - *Accounting for the Effects of Certain Types of Regulation*. 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. FAS 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. See Note F.

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 Statement of Net Assets are valued at fair market value.

Receivables:

Lakeland Electric bills customers monthly on a cyclical basis. An estimate of uncollectible accounts is recognized based upon historical experience. Lakeland Electric has recognized in receivables an estimated amount for services rendered but not yet billed as of September 30, 2008 and 2007, respectively.

Inventories:

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

Restricted and Apportioned Assets:

Revenue bond ordinances and certain other agreements with parties outside the City require the restriction of certain fund assets for specific purposes such as bond proceeds, which are restricted by revenue bond ordinance to finance certain capital improvements, and meter deposits held on behalf of utility customers. Apportionments do not represent legal restrictions imposed by parties external from the local government and they maybe rescinded at any time. See Notes G and H.

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 L.

NOTE A -SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

Contributions in Aid of Construction:

Non-refundable payments received from consumers and developers for extension of electric services, and funds received from developers and customers for assets owned and maintained by Lakeland Electric, are recorded as capital contributions in the period in which they have been received on the Statements of Revenues, Expenses and Changes in Net Assets. For financial reporting purposes, there is a corresponding expense for contributed plant costs in the Statements of Revenues, Expenses and Changes in Net Assets.

Utility Plant:

Lakeland Electric records the acquisition and disposition of assets substantially in accordance with the guidelines of the Federal Energy Regulatory Commission. Utility plant and equipment are recorded at cost. Electric plant does not include cost or other value that has been contributed. These funds are recorded as reductions to gross plant costs and amortized over the life of the related assets. Interest costs on funds used for the construction of utility plant are capitalized as part of the costs of these assets.

Impaired assets are recorded in accordance with Governmental Accounting Standard No. 42 *"Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries"*. During the year ending September 30, 2008, an impairment write-down of $3,668,075 was recorded on the Lakeland Electric's former *Operations Center* building which, because of environmental issues, is estimated to be more expensive to repair than to rebuild. A portion of the building will continue to house the City of Lakeland's phone switch during fiscal year 2009, and the building is expected to be completely out of service by the end of fiscal year 2009.

Routine maintenance and repairs, including additions and improvements of less than $2,500 are charged to operating expense as incurred. Individual equipment items with a cost of $1,000 or more are capitalized. In accordance with accounting requirements 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 are depreciated prior to being placed in service. 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

Total depreciation expense as a percentage of depreciable assets was 3.2 percent and 3.5 percent in 2008 and 2007 respectively.

Amortization:

Bond issue costs and bond discount are amortized over the life of the issue using the straight-line method. Lakeland Electric considered the effective interest method of amortizing bond discounts and determined that no material difference results from the continued use of the straight-line method.

NOTE A -SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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	
	2008	2007
Annual dividend to the City of Lakeland	$ 23,387,004	$ 16,600,000
Transfers to City funds for fixed assets	8,000	-
Transfer to Fleet Management Fund for new vehicles	35,796	-
	$ 23,429,800	$ 16,600,000

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 (See Note M, Long-Term Debt – accrued liabilities).

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

Reclassification:

For comparability, certain fiscal year 2007 amounts have been reclassified to conform to the financial statement presentation for fiscal year 2008. Such reclassifications had no effect on previously reported net assets.

Other Significant Accounting Policies:

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

NOTE B – NEW ACCOUNTING PRONOUNCEMENTS

In June 2008, the GASB issued Statement No. 53, Accounting and Financial Reporting for Derivative Instruments. This Statement addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. Statement No. 53 is effective for the City's fiscal year ending September 30, 2010. Lakeland Electric is currently evaluating the impact of adopting Statement No. 53.

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.

The following is a summary of the key controls which the City of Lakeland utilizes to mitigate investment risk:

Interest rate risk exists when there is a possibility that changes in interest rates could adversely affect an investment's fair value. The City utilizes the "segmented time distribution" method as a measure of interest rate risk.

Credit risk is the risk of loss due to the failure of the security issuer or other counterparty.

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, 2008 was $29,243,813. By comparison, the carrying amount of Lakeland Electric's pooled demand and time deposits in fiscal year 2007 was $23,637,709.

The types of investments in which the City of Lakeland may directly invest are governed by several forms of legal and contractual provisions. The City of Lakeland 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. The City of Lakeland 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.

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

As of September 30, 2008, Lakeland Electric's share of the City's Investment Pool debt security investments had the following credit quality ratings:

S&P Rating:	Cost	%	Market	%
AAA	$ 103,746,646	71.88%	$ 103,821,913	72.98%
AA+ to AA-	18,299,729	12.68%	18,286,712	12.85%
A+ to A-	9,788,991	6.78%	8,923,307	6.27%
BBB+ to BBB-	5,702,328	3.95%	5,090,386	3.58%
BB+ to BB-	-	0.00%	-	0.00%
Below BB-	1,141,352	0.79%	1,018,096	0.72%
NR	5,654,361	3.92%	5,120,700	3.60%
	$ 144,333,407	100.00%	$ 142,261,113	100.00%
Moody's Rating:				
Aaa	$ 90,218,157	62.51%	$ 90,363,048	63.52%
Aa1 to Aa3	9,655,047	6.69%	9,613,805	6.76%
A1 to A3	13,878,198	9.62%	13,548,978	9.52%
Baa1 to Baa3	10,684,975	7.40%	9,562,222	6.72%
Ba1 to Ba3	-	0.00%	-	0.00%
Below Ba3	481,100	0.33%	356,888	0.25%
NR	19,415,931	13.45%	18,816,173	13.23%
	$ 144,333,407	100.00%	$ 142,261,113	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, 2008 are as follows:

Type of Security (Market)	Maximum % of Total	% of Total
US Government Obligations	100%	-
Local Government Investment Pools	100%	5.68%
Certificates of Deposits	25%	0.47%
Federal Agency & Instrumentality Obligations	100%	56.39%
Collateralized Repurchase Agreements	15%	1.72%
Other Investment Pools (rated "A" or better)	10%	-
Mutual Funds	10%	-
High Grade Corporate Debt	10%	6.30%
Investment Grade Obligations of State and Local Govts	10%	29.44%
Money Market Mutual Funds	10%	-

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

As of September 30, 2008 and 2007 the fair value of the total investment pool and Lakeland Electric's share of the pool was as follows:

	Reported Amount Fair Value
As of September 30, 2008:	
Total Investment Pool	$ 338,939,534
Lakeland Electric's Share of the Investment Pool	$ 144,399,744
As of September 30, 2007:	
Total Investment Pool	$ 262,271,356
Lakeland Electric's Share of the Investment Pool	$ 91,937,960

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

Pooled Investments – Swap Transaction:

In late October of 2006, the City entered into a series of forward starting, fixed receiver investment swap transactions with two counterparties that are intended to accommodate a laddered re-investment strategy for the City's pooled investment portfolio. The total notional amount of the swaps is $148,184,386 with commencement dates starting on February 7, 2007 and maturing no later than December 31, 2013.

The portfolio of swaps is intended to provide certainty over the fixed rate of return that will be realized upon the reinvestment of large amounts of investments held within the City's pooled investment fund that mature in four large blocks in February, August, and October of 2007, October of 2008, and January of 2009. The notional amounts and start dates of the swap transactions entered into correspond exactly to the maturity amount and maturity dates of these four investments.

It was anticipated that each swap transaction would be terminated at its then market value on the scheduled start date. Any termination payment made or received on each of those dates will enable the City to acquire government-backed fixed rate investments at effective yields which, considered together with any cash flow resulting from termination of the swap, will range between 5.00 and 5.06 percent rate.

Alternatively, the City could elect to accept delivery of each swap transaction on its scheduled start date, in which case the City will receive a fixed rate of interest ranging from 5.00 to 5.06 percent multiplied by the notional amount of each swap. The City would pay the counterparty a variable amount equal to the notional amount multiplied by 94.875 percent of 1 month LIBOR plus 17 basis points. Under this scenario, the City would re-invest the proceeds from the investment of the currently held fixed-rate investments in short term money market investment instruments held within the City's pooled investment program.

Two of the swaps were terminated at their market values during FY 2007, yielding a positive cash flow to the City in the amount of $343,000. Two additional swaps were terminated during FY 2008 yielding a positive cash flow to the City of $2,752,672. As of September 30, 2008 the remaining swap transaction had a positive market value of approximately $918,176. Subsequent to year-end, the City terminated the remaining swap agreement and received a payment of $2,075,000.

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

Cash, cash equivalents and investments are included in the following captions in the accompanying Statement of Net Assets:

	September 30	
	2008	2007
Current assets:		
Cash and cash equivalents	$ 28,199,996	$ 19,297,179
Asset Apportionments:		
Cash and cash equivalents	92,836,635	73,483,281
Restricted assets		
Cash and cash equivalents	50,898,148	25,772,865
	$ 171,934,979	$ 118,553,325

NOTE D - INVENTORIES

The major classes of inventory consist of the following:

	September 30	
	2008	2007
Fuel oil	$ 11,420,850	$ 11,018,098
Coal	1,482,114	10,945,915
Spare parts	16,769,111	16,688,591
	$ 29,672,075	$ 38,652,604

NOTE E - 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. Lakeland Electric has a long-term service agreement with Siemens Westinghouse to provide parts and maintenance for its largest gas turbine Unit (McIntosh 5). Total Other Current Assets are comprised of the following:

	September 30	
	2008	2007
Prepaid fuel	$ 8,730	$ 124,728
Prepaid Maintenance - McIntosh 5 Unit	7,366,252	7,500,729
Other prepaid expenses	110,737	99,392
	$ 7,485,719	$ 7,724,849

NOTE F – DEFERRED REGULATORY ACCOUNTS

SFAS No. 71 requires that public utilities recognize revenues provided either before or after the costs are incurred as assets or liabilities. Lakeland Electric's deferred regulatory assets/liabilities represents the amount due from (or payable to) retail customers for the cumulative difference between fuel costs incurred to serve retail load and fuel revenues realized.

As of September 30, 2008, cumulatively, fuel costs exceeded fuel revenues in the amount of $2,209,839. The under-recovery of fuel costs is classified as a current asset on the Statement of Net Assets in 2008. Comparatively, as of September 30, 2007, fuel revenues exceeded fuel costs on a cumulative basis in the amount of $2,746,318. The over-recovery was classified as a current liability in the Statement of Net Assets in 2007.

The following table summarizes the regulatory account balances as of September 30, 2008 and September 30, 2007:

	September 30	
	2008	2007
Deferred regulatory asset (liability), beginning balance	$ (2,746,318)	$ 7,737,949
Fuel charges recovered through rates	213,236,366	244,818,352
Less fuel and purchased power expenses	218,192,524	234,334,085
Deferred regulatory asset (liability), ending balance	$ 2,209,839	$ (2,746,318)

[Remainder of this page intentionally left blank]

NOTE G - RESTRICTED ASSETS

The revenue bond ordinances and certain other agreements require the restriction of certain assets for specific purposes. Lakeland Electric's unspent bond proceeds as of September 30, 2008 are from Series 2006 bonds, Series 2008A and Series 2008B refunding bonds which were issued to finance certain capital improvements and refunding $10,000,000 of outstanding debt. The customer deposits balance represents cash held from electric customers, which is completely offset by a liability payable from restricted assets. Guarantees from customers, other than cash, are not recorded as assets or liabilities on Lakeland Electric's Statement of Net Assets.

Lakeland Electric's restricted assets and restricted liabilities due within twelve months, as of September 30, 2008 and 2007 consist of the following:

	Bond Proceeds	Customer Deposits	Total Restricted
September 30, 2008:			
Cash and cash equivalents	$ 39,037,483	$ 11,860,665	$ 50,898,148
Accounts receivable	5,554,798	-	5,554,798
Restricted assets	44,592,281	11,860,665	56,452,946
Accounts payable	$ 5,160,093	$ -	$ 5,160,093
Accrued expenses	31,634	-	31,634
Accrued interest payable	-	134,053	134,053
Meter deposits payable	-	11,726,611	11,726,611
Restriced liabilities, due within twelve months	$ 5,191,727	$ 11,860,664	$ 17,052,391

	Bond Proceeds	Customer Deposits	Total Restricted
September 30, 2007:			
Cash and cash equivalents	$ 14,603,135	$ 11,169,730	$ 25,772,865
Accounts receivable	519,208	-	519,208
Restricted assets	15,122,343	11,169,730	26,292,073
Accounts payable	$ 1,900,116	$ -	$ 1,900,116
Accrued expenses	52,291	-	52,291
Accrued interest payable	-	14,497	14,497
Meter deposits payable	-	11,155,233	11,155,233
Restriced liabilities, due within twelve months	$ 1,952,407	$ 11,169,730	$ 13,122,137

NOTE H – ASSET APPORTIONMENTS

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 apportioned for the purpose of paying current principal and interest requirements.

Asset apportionments and related liabilities of Lakeland Electric as of September 30, 2008 and 2007 consist of the following:

September 30, 2008:	Debt Service Funds	Capital Expansion	Emergency Repair	Total Designated
Cash and cash equivalents	$ 2,753,522	$ 52,282,934	$ 10,266,668	$ 65,303,124
Cash with paying agent/trustee	27,533,711	-	-	27,533,711
Accounts receivable	-	255,456	-	255,456
Due from other governments	-	311,048	-	311,048
Advances to other funds	13,353,647	-	-	13,353,647
Asset apportionments	$ 43,640,880	$ 52,849,438	$ 10,266,668	$ 106,756,986
Current portion of revenue bonds payable	$ 18,760,000	$ -		$ 18,760,000
Accounts payable	-	1,535,182	-	1,535,182
Accrued expenses	-	409,781	-	409,781
Accrued interest payable	9,416,050	-	-	9,416,050
Liabilities payable from apportioned assets, due within twelve months	$ 28,176,050	$ 1,944,963	- $ -	$ 30,121,013

September 30, 2007:	Debt Service Funds	Capital Expansion	Emergency Repair	Total Designated
Cash and cash equivalents	$ 498,601	$ 36,798,012	$ 9,572,826	$ 46,869,439
Cash paying agent/trustee	26,613,842	-	-	26,613,842
Accounts receivable	-	98,723	-	98,723
Due from/(to) other governments	-	199,929	-	199,929
Advances to other funds	13,383,778	-	-	13,383,778
Asset apportionments	$ 40,496,221	$ 37,096,664	$ 9,572,826	$ 87,165,711
Current portion of revenue bonds payable	$ 17,300,000	$ -	$ -	$ 17,300,000
Accounts payable	-	1,052,571	-	1,052,571
Accrued expenses	-	397,514	-	397,514
Accrued interest payable	9,455,558	-	-	9,455,558
Liabilities payable from apportioned assets, due within twelve months	$ 26,755,558	$ 1,450,085	$ -	$ 28,205,643

NOTE I - OTHER NONCURRENT ASSETS

Other Assets (noncurrent) of Lakeland Electric as of September 30, 2008 and 2007 consist of the following:

	September 30	
	2008	2007
Unamortized bond issue costs	$ 6,356,090	$ 4,179,617
Net pension obligation	3,488,959	3,291,474
	$ 9,845,049	$ 7,471,091

NOTE J - UTILITY PLANT

Utility plant in service consists of the following::

Fiscal year 2008:	September 30, 2007	Additions	Deletions	September 30, 2008
Non-depreciable assets:				
Land	$ 15,502,273	$ 111,121	$ -	$ 15,613,394
Construction in process	20,929,195	39,502,108	9,531,788	50,899,515
	36,431,468	39,613,229	9,531,788	66,512,909
Depreciable assets:				
Buildings	29,941,197		6,629,340	23,311,857
Machinery and equipment	37,620,919	8,466,372	7,449,533	38,637,758
Electric plants in service				
Electric transmission and distribution	344,296,640	12,846,253	11,928,327	345,214,566
Electric production plant in service	647,228,330	11,801,815	70,661,768	588,368,377
Total plant assets	1,095,518,554	72,727,669	106,200,756	1,062,045,467
Less accumulated depreciation:				
Buildings	10,573,927	754,617	3,220,528	8,108,016
Machinery and equipment	20,683,943	3,576,783	667,686	23,593,040
Electric transmission and distribution	115,373,194	9,509,763	11,928,336	112,954,621
Electric production plant in service	337,300,069	18,506,944	48,502,005	307,305,008
	483,931,133	32,348,107	64,318,555	451,960,685
Total utility plant net of accumulated depreciation	$ 611,587,421	$ 40,379,562	$ 41,882,201	$ 610,084,782

Fiscal year 2007:	September 30, 2006	Additions	Deletions	September 30, 2007
Non-Depreciable Assets:				
Land	$ 15,197,098	$ 305,175	$ -	$ 15,502,273
Construction in process	20,771,784	26,484,221	26,326,810	20,929,195
Total capital assets not being depreciated	35,968,882	26,789,396	26,326,810	36,431,468
Depreciable Assets:				
Buildings	29,889,580	51,617	-	29,941,197
Machinery and equipment	35,063,142	2,750,415	192,638	37,620,919
Electric plants in service				
Electric transmission and distribution	340,191,129	7,393,425	3,287,914	344,296,640
Electric production plant in service	628,351,151	19,810,664	933,485	647,228,330
Total plant assets	1,069,463,884	56,795,517	30,740,847	1,095,518,554
Less accumulated depreciation:				
Buildings	9,841,586	732,341	-	10,573,927
Machinery and equipment	17,677,854	3,357,152	351,063	20,683,943
Electric transmission and distribution	122,128,471	10,019,553	16,774,830	115,373,194
Electric production plant in service	314,282,557	23,373,258	355,746	337,300,069
	463,930,468	37,482,304	17,481,639	483,931,133
Total utility plant net of accumulated depreciation	$ 605,533,416	$ 19,313,213	$ 13,259,208	$ 611,587,421

NOTE J - UTILITY PLANT (CONTINUED)

Salvage Value:

Utility plant in service for the year ending September 30, 2007 includes an amount of $14,275,866 for negative salvage value, as recommended in a depreciation study of plant assets, and representing the estimated present value of the future cost to remove existing generation plant structures (see Note O – Asset Retirement Obligations), in accordance with FERC order 631. The Statement of Net Assets for the fiscal ending September 30, 2008 no longer includes a balance for negative salvage value based on a legal opinion that Lakeland Electric is under no future obligation to remove any of its generation facilities.

Capitalized interest:

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. As required by the provisions of these pronouncements, interest costs and interest earnings have been capitalized as follows:

	September 30	
	2008	2007
Net capitalized interest		
Interest expense capitalized	$ 1,014,076	$ 509,080
Interest revenue capitalized on bond proceeds	(853,975)	(1,022,338)
	$ 160,101	$ (513,258)
Interest cost was reduced by amounts capitalized as follows:		
Total interest paid	27,896,651	25,659,103
Less capitalized interest expense	(1,014,076)	(509,080)
	$ 26,882,575	$ 25,150,023

NOTE K - 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 L - DUE TO OTHER FUNDS

Lakeland Electric's liabilities include an advance from the Department of Information Technology (DOIT) for Lakeland Electric's share of the City of Lakeland's radio system. The $137,473 current portion of the advance is shown as a current liability on the Statement of Net Assets for both 2008 and 2007. The noncurrent portion of this liability is classified as an *advance from other funds, less current portion* in amount of $412,419 and $549,892 for fiscal years 2008 and 2007, respectively.

NOTE M - LONG-TERM DEBT

Accrued liabilities are classified on the Statement of Net Assets as follows:

	September 30	
	2008	2007
Current:		
Accrued taxes payable	$ 928,866	$ 1,002,677
Compensated absences	2,813,586	2,423,601
	$ 3,742,452	$ 3,426,278
Accrued liabilities, less current portion:		
Compensated absences	$ 4,699,892	$ 4,707,859
Other post employment benefits	2,446,639	-
Accrued capital appreciation interest payable	19,215,254	16,743,494
Advance bond refunding receipts	7,680,000	7,680,000
	$ 34,041,785	$ 29,131,353

Long term debt, due beyond twelve months consists of the following:

	September 30	
	2008	2007
Revenue bonds payable, less current portion	$ 547,175,409	$ 505,410,409
Less unamortized loss on refunding	(16,565,250)	(17,623,426)
Plus (less) unamortized bond discount (net of premium)	297,988	(401,621)
	$ 530,908,147	$ 487,385,362

NOTE N - REVENUE BONDS

Lakeland Electric revenue bonds payable as of September 30, 2008:

	Interest Rate %	Final Maturity	September 30, 2007	Additions	Deletions	September 30, 2008
Series 1999A	3.05% to 5.00%	10-01-2036	$ 192,655,409	$ -	$ 600,000	$ 192,055,409
Series 1999B	5.3% to 6.55%	10-01-2014	51,185,000	-	11,130,000	40,055,000
Series 1999C	5.3% to 6.55%	10-01-2012	64,525,000	-	5,095,000	59,430,000
Series 2001B	5.00% to 5.50%	10-01-2018	30,000,000	-	-	30,000,000
Series 2006	4.00% to 5.00%	10-01-2036	44,870,000	-	475,000	44,395,000
Series 2006 A1	Variable	10-01-2037	69,750,000	-	69,750,000	-
Series 2006 A2	Variable	10-01-2037	69,725,000	-	69,725,000	-
Series 2008A	Variable	10-01-2037	-	100,000,000	-	100,000,000
Series 2008B	Variable	10-01-2037	-	100,000,000	-	100,000,000
			$ 522,710,409	$ 200,000,000	$ 156,775,000	$ 565,935,409
			(17,300,000)			(18,760,000)
			$ 505,410,409			$ 547,175,409

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 $13,353,647, which was offset by an Advance to Other Funds (asset apportionments, Note H).

NOTE N - REVENUE BONDS (CONTINUED)

The following is a schedule of the debt service requirements, excluding the current portion for outstanding revenue bonds and excluding the impact of interest swaps on variable rate bonds as of September 30, 2008:

	Series 1999A Sr.		Series 1999B Sr.		Series 1999C Sr.	
Fiscal Year(s)	Principal	Interest	Principal	Interest	Principal	Interest
2009	$ 6,700,719	$ 11,683,794	$ 12,740,000	$ 1,760,725	$ 5,775,000	$ 3,270,630
2010	6,307,218	12,082,295	-	926,255	14,865,000	2,921,243
2011	5,952,510	12,437,003	-	926,255	16,180,000	2,021,910
2012	5,626,268	12,758,244	-	926,255	17,240,000	1,043,020
2013	5,308,195	13,081,318	6,815,000	926,255	-	-
2014-2018	51,080,499	41,238,601	8,495,000	513,948	-	-
2019-2023	29,225,000	23,851,500	-	-	-	-
2024-2028	25,340,000	17,896,250	-	-	-	-
2029-2033	32,345,000	10,895,500	-	-	-	-
2034-2038	23,545,000	2,392,750	-	-	-	-
	$ 191,430,409	$ 158,317,254	$ 28,050,000	$ 5,979,693	$ 54,060,000	$ 9,256,803

	Series 2001B Sr.		Series 2006 Sr.		Series 2008A	
Fiscal Year(s)	Principal	Interest	Principal	Interest	Principal	Interest
2009	$ -	$ 1,561,100	$ 785,000	$ 2,096,094	$ 1,165,000	$ 2,880,000
2010	-	1,561,100	820,000	2,064,694	1,125,000	2,846,448
2011	-	1,561,100	855,000	2,031,894	1,165,000	2,814,048
2012	-	1,561,100	885,000	1,997,694	1,195,000	2,780,496
2013	6,565,000	1,561,100	930,000	1,953,444	1,235,000	2,746,080
2014-2018	23,435,000	3,476,525	5,310,000	9,105,238	6,800,000	13,173,408
2019-2023	-	-	6,705,000	7,717,313	15,160,000	11,926,368
2024-2028	-	-	8,550,000	5,866,313	23,385,000	9,093,888
2029-2033	-	-	10,900,000	3,510,025	17,235,000	6,069,024
2034-2038	-	-	7,895,000	761,663	31,535,000	2,286,576
	$ 30,000,000	$ 11,282,025	$ 43,635,000	$ 37,104,369	$ 100,000,000	$ 56,616,336

	Series 2008B		TOTAL		
Fiscal Year(s)	Principal	Interest	Principal	Interest	Total
2009	$ 1,015,000	$ 2,640,000	$ 28,180,719	$ 25,892,343	$ 54,073,061
2010	1,120,000	2,613,204	24,237,218	25,015,238	49,252,456
2011	1,155,000	2,583,636	25,307,510	24,375,845	49,683,355
2012	1,195,000	2,553,144	26,141,268	23,619,953	49,761,221
2013	1,240,000	2,521,596	22,093,195	22,789,793	44,882,987
2014-2018	6,800,000	12,096,480	101,920,499	79,604,199	181,524,698
2019-2023	15,135,000	10,954,944	66,225,000	54,450,125	120,675,125
2024-2028	23,420,000	8,358,240	80,695,000	41,214,691	121,909,691
2029-2033	17,335,000	5,583,600	77,815,000	26,058,149	103,873,149
2034-2038	31,585,000	2,101,044	94,560,000	7,542,033	102,102,033
	$ 100,000,000	$ 52,005,888	$ 547,175,409	$ 330,562,367	$ 877,737,775

NOTE N - REVENUE BONDS (CONTINUED)

The following is a schedule of combined senior and junior lien revenue bond coverage for fiscal year 2008 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
2008	$ 95,251,355	$ 18,760,000	$ 25,661,622	$ 44,421,622	2.14	2.96
2007	76,058,287	17,300,000	24,885,697	42,341,849	1.80	2.58
2006	68,237,133	575,000	23,093,002	23,668,002	2.88	4.01
2005	70,275,504	15,095,000	22,439,513	37,534,513	1.87	2.77
2004	78,217,987	13,250,000	22,416,570	35,666,570	2.19	3.08
2003	83,203,722	11,745,000	23,940,421	35,685,421	2.33	3.03

Bond debt coverage for the year ended September 30, 2008 was calculated as follows:

Charges for services	$ 384,493,828	
Investment and other income	4,540,106	
Total revenue		$ 389,033,934
Less cost of operations		(293,782,579)
Net revenues from operations available for debt service		95,251,355
Fund balance (as defined by bond ordinance):		
Cash and equivalents	$ 28,199,996	
Asset apportionments	106,756,986	
Accounts receivable (net of uncollectables)	45,649,595	
	$ 180,606,577	
20% of fund balance		36,121,315
Net available revenues plus 20% of fund balance		$ 131,372,670
Debt service requirement:		
Interest on bond debt		$ 25,661,622
Principal		18,760,000
Total		$ 44,421,622
Bond coverage		2.96
Bond coverage from operations		2.14

NOTE N - 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, 2008, all funds and accounts required by the bond ordinance were being maintained in conformance with the ordinance.

Revenue Bond Replacement Transactions:

In August of 2006, the City retired both the Energy System Variable Rate Revenue Bonds; Series 2001A with a principal amount of $90,000,000, and the System Variable Rate Refunding Revenue Bonds Series 2003, with a principal amount of $47,860,000. These two bond issues were retired by the Energy System Refunding Revenues Bonds Series 2006A, issued in the aggregate amount of $139,475,000. The intent of the transaction was to convert the structure of the underlying debt obligation from a Variable Rate Demand Obligation to an Auction Reset Security structure. The transaction resulted in a loss of $6,073,130 which is to be amortized over the life of the replacement bonds. The majority of that loss was the result of the early write-off of unamortized bond issue costs totaling $6,059,172 on the 2001A and 2003 bond issues, which includes unamortized loss on refunding of $5,472,657 on those retired bonds. The incremental cost of the transaction was approximately $1.6 million in issue costs associated with the replacement debt, which will be amortized over the lifetime of the replacement bonds

The 2006A bonds were themselves retired from the proceeds of two repurchase agreements entered into between the City of Lakeland and Goldman Sachs in February of 2008. Those repurchase agreements were subsequently retired from a portion of the proceeds of the Variable Rate Energy System Revenue and Refunding Revenues Bonds Series 2008A and 2008B issued in August of 2008 in the aggregate amount of $200,000,000. The replacement bonds take the form of Variable Rate Demand Obligations (VRDO's). That transaction resulted in a loss of $7,860,345. The majority of that loss was the result of the early write-off of unamortized bond issue costs totaling $7,185,345 on the 2006A bond issue, which includes unamortized loss on refunding of $5,686,288 on those retired bonds. The incremental cost of the transaction was approximately $2.9 million in issue costs associated with the replacement debt, which included $56,856,671 of new money proceeds necessary to construct certain improvements to the electric generation and distribution system.

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 25.9 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, 2008, the swap had a negative fair value of $2,578,530 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, 2008, 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 74.1 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 N - REVENUE BONDS (CONTINUED)

Interest Rate Swaps (continued):

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 will corresponds with the maturity schedule on the Series 2003 bonds. Settlement payments on this swap are made monthly. As of September 30, 2008, the swap had a negative fair value of $4,693,256 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, 2008, 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 the both the Energy System Variable Rate Revenue Bonds, Series 2001A and the System Variable Rate Refunding Revenue Bonds Series 2003. These two bond issue were retired by the Energy System Refunding Revenues Bonds Series 2006A, issued in August of 2006. The 2006A bonds were themselves retired from the proceeds of two repurchase agreements entered into between the City of Lakeland and Goldman Sachs in February of 2008. Those repurchase agreements were retired from a portion of the proceeds of the Variable Rate Energy System Revenue and Refunding Revenues Bonds Series 2008A and 2008B issued in August of 2008. The replacement bonds take the form of Variable Rate Demand Obligations (VRDO's). The City elected to retain the financial benefits of the original 2001A and 2003 basis risk associated with the aforementioned swap transactions and integrate those swaps into the refunding bond issue. Accordingly, the annual maturity dates and maturity amounts for the refunding and refunded bonds are essentially identical.

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, which were themselves refunded by a portion of the proceeds from issuance of the Variable Rate Energy System Revenue and Refunding Revenues Bonds Series 2008A and 2008B issued in August of 2008. 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 at portion of the million of Energy System Refunding Revenues Bonds Series 2006A allocated to refunding the Energy System Variable Rate Revenue Bonds, Series 2001A. As of September 30, 2008, the two swaps had a combined negative fair value of $5,999,232 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, 2008, 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 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 N - REVENUE BONDS (CONTINUED)

Interest Rate Swaps (continued):

As previously mentioned, in August of 2008, the City issued the Variable Rate Energy System Revenue and Refunding Revenues Bonds Series 2008A and 2008B in the aggregate amount of $200,000,000. The proceeds of these bonds were used to retire outstanding variable rate debt of the City and to provide approximately $45,000,000 of new proceeds to finance capital expansion of the electric system. In order to reduce borrowing costs on that $45,000,000 portion of this bond issue when compared to the market rates paid by issuers of fixed–rate bonds, the City entered into a swap in August of 2008. Under the swap, the City pays Goldman Sachs (the counterparty) a payment equal to $45,000,000 (the notional amount) times a fixed interest rate of 3.637 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 3.637 percent plus the cost of liquidity and remarketing fees on the underlying variable rate issue. The notional amount of the swap corresponds with the maturity schedule on the new money component of the Series 2008A bonds. Settlement payments on this swap are made monthly. As of September 30, 2008, the swap had a negative fair value of $2,771,520 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, 2008, 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 of September 30, 2008, future debt service requirements on the $200,000,000 of variable-rate debt issued in conjunction with the Series 2008A and B 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 3.84 percent as of September 30, 2008; and effective LIBOR interest rate of 5.124 percent as of September 30, 2007. As rates vary, variable rate bond interest payments and net swap payments will vary.

Fiscal Year Ending September 30,	Variable-Rate Bonds Principal	Variable-Rate Bonds Interest	Interest Rate Swaps, Net	Total
2009	$ 2,180,000	$ 10,540,000	$ 3,677,455	$ 16,397,455
2010	2,245,000	10,407,870	3,661,959	16,314,829
2011	2,320,000	10,289,868	3,645,931	16,255,799
2012	2,390,000	10,168,005	3,629,283	16,187,288
2013	2,475,000	10,042,291	3,612,104	16,129,395
2014-2018	13,600,000	48,174,453	17,777,150	79,551,603
2019-2023	30,295,000	43,623,464	14,521,368	88,439,832
2024-2028	46,805,000	33,276,349	10,092,058	90,173,407
2029-2033	34,570,000	22,222,326	7,642,804	64,435,130
2034-2037	63,120,000	8,365,562	3,130,814	74,616,376
	$ 200,000,000	$ 207,110,188	$ 71,390,926	$ 478,501,114

NOTE N - REVENUE BONDS (CONTINUED)

Interest Rate Swaps (continued):

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 $159,000,000 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, 2007, the swap had a negative fair value of $2,718,866 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, 2008, 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.

Bond Warrant 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 City has recognized the proceeds of this transaction on the Statement of Net Assets of the Department of Electric Utilities as a deferred credit. To the extent the underwriter exercise their option to require issuance of new bonds that deferred credit will be amortized to the income statement of Department of Electric Utilities 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 a charge against income in its entirety in the fiscal year ending September 30, 2012.

NOTE O – ASSET RETIREMENT OBLIGATIONS

Per FERC order No. 631, Electric Utilities must estimate and record the present value of future legal obligations related to the final removal of its plants and facilities. Lakeland Electric's Statement of Net Assets for the year ending September 30, 2007, includes an asset retirement obligation in the amount of $14,275,866 representing the estimated present value of the future cost of removing its existing electric generation structures. During 2008, a legal opinion concluded that Lakeland Electric is under no future legal obligation to remove abandoned generation facilities, therefore, no balance for the plant retirement obligations is included in the Statement of Net Assets for the year ending September 30, 2008.

NOTE P - EMPLOYEE RETIREMENT SYSTEM

The City of Lakeland 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. As of September 30, 2008 the contribution rates were 8 percent for the employee portion and 14.89 percent for the City portion. The contribution rates for the City and the employee portion were each increased by one-half of a percent effective January 2009. Lakeland Electric's contributions to the City of Lakeland's pension fund totaled $4,823,686 and $4,569,730 during fiscal years 2008 and 2007, respectively.

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.

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 Q - BUSINESS SEGMENT

Lakeland Electric is a department of the City of Lakeland, operating in only one business segment, that of providing electric utility service. The City of Lakeland has been generating power and providing electric service since 1904. Its service area is primarily the City of Lakeland and the immediate area surrounding the City.

NOTE R - POST-EMPLOYMENT BENEFITS

In addition to the pension benefits described in Note P, 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. Lakeland Electric's annual cost of this benefit was $458,259 during fiscal year 2008, funded on a pay-as-you-go basis.

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, 2008, more than 200 retired employees of Lakeland Electric participated in the program.

In accordance with the implementation of Governmental Accounting Standard No. 45 for the treatment of *Other Post Employment Benefits (OPEB*), the City has measured the long-term liability and associated required contributions necessary to finance the explicit subsidy provided to retired employees as a percentage of annual insurance premiums, and an implicit subsidy associated with the state mandate that health insurance premiums for retired employee equal the amount charged to active employees, without regard to the increased health insurance costs associated with retired employees based on claims experience. The City has elected to fund the explicit subsidy within a format Trust established to accumulate and invest assets necessary to pay for the accumulated liability. The City has not established a trust to finance cost of the implicit subsidy.

The dollar value of the actuarial accrued liability associated with the explicit subsidy was $34,295,504 as of September 30, 2008. The dollar value of the actuarial accrued liability associated with the implicit subsidy was $71,127,071 as of September 30, 2008. The projected Net OPEB obligation – which represents the excess of the annual required contribution necessary to amortize both the explicit and implicit subsidies on an actuarially sound basis over the amount actually funded on a pay-as-you go basis was $7,367,969 for the City as a whole. The portion of that increase in the liability attributable to the operations of the electric system was $2,446,639. That amount has been included in the financial statements as an increase in operating expenses on the Statement of Revenues, Expenses and Changes in Net Assets and as an additional non-current liability on the Statement of Net Assets.

NOTE S - 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 Deferred Compensation 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 T – DERIVATIVE AND HEDGING ACTIVITIES

Accounting for Derivatives and Hedging Activities:

Fuel related derivative transactions are executed in accordance with the 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 fuel rate stabilization 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 policy compliance. Acquisition of these hedge transactions are managed by The Energy Authority (TEA) based on a contractual relationship created in March 2007. TEA performs the front and back office functions associated with such trades, in accordance with overall hedging policies developed jointly by TEA and the aforementioned oversight committee of Lakeland Electric.

The recording of fuel derivatives, when appropriate, is included on the Statement 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 Statement of Revenues, Expenses and Changes in Net Assets. The valuation of market changes for contracts entered into within Lakeland Electric's Risk Management Program resulted in a net increase of $6,572,954 for the cost of fuel during the fiscal year ended September 30, 2008.

Recent Accounting Pronouncements:

The City follows the guidance of FAS 80 with respect to accounting for futures contracts acquired through the New York Mercantile Exchange (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.

The City 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. Derivative instruments are used by Lakeland Electric in conjunction with both debt financing and fuel purchases. Fuel related derivatives information is included herein and Debt related derivative information is included in Note N – Revenue Bonds, Interest Rate Swaps.

Derivative Instruments:

The City of Lakeland uses the NYMEX, natural gas futures contracts, over the counter (OTC) swaps, options on future 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 and OTC swaps mature with a period of 30 months from the Statement of Net Assets date. Any gain or loss of the value of these derivatives are ultimately rolled into the price of natural gas burned, offsetting the volatility in the price of that fuel. As of September 2008, the City of Lakeland had the following options, swaps and physical contracts outstanding in the following amounts, covering fiscal years 2009 – 2027:

NOTE T – DERIVATIVE AND HEDGING ACTIVITIES (CONTINUED)

Fiscal Year	Options	Swaps	Physicals	Market-to- Market Value at 9/30/08
2009	9,415,000	7,020,000	269,000	$ (1,952,744)
2010	1,380,000	2,320,000	74,000	107,344
2011	-	920,000	29,000	815,763
2012	-	920,000	29,000	614,973
2013	-	920,000	29,000	529,232
2014-2018	-	155,000	145,000	105,914
2019-2023	-	-	145,000	-
2024-2027	-	-	116,000	-
	10,795,000	12,255,000	836,000	$ 220,482

Natural Gas Commodity Swap

In Fiscal Year 2007, the City 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, which is 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 swap provider from its account on NYMEX. As a result of this transaction, the City 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.

However, because the commodity swap transaction represented a trade at prices that were above then-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 Statement of Net Assets of the Electric Utility fund and was amortized over the remaining term of the underlying commodity swaps. Of the $428,926 capitalized, $358,198 was expensed during fiscal year 2007 and $61,998 was expensed during fiscal year 2008. The remaining $8,730 is classified as prepaid fuel. See Note E – Other Current Assets.

NOTE U - 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 V - 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, 2008, 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 V - 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. 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 eighteen major customers to provide their electric energy requirements. As of September 30, 2008, there were six major customers with seventeen accounts.

Lakeland Electric has a long term service agreement with Siemens/Westinghouse through fiscal year 2011 to provide labor, parts, and materials to cover all planned outages for McIntosh Unit 5, a 360 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. As of September 30, 2008 Lakeland Electric was in the process of renegotiating with Siemens/Westinghouse due to performance issues associated with McIntosh Unit 5. Although the renegotiated settlement is expected to be economically favorable to Lakeland Electric, the actual provisions are not expected to be determined until June 2009. As a result of the operational issues related to McIntosh Unit 5, the annual maintenance payment that was scheduled to be paid during fiscal year 2008 was canceled. Annual payments, the majority of which will ultimately be capitalized as replacement parts, are scheduled, per the existing terms of the contract, as follows:

Fiscal Year	Amount
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 allowed the FMPA the option of taking up to 100 megawatts of energy per hour at a fixed cost. Significant increases in fuel costs resulted in substantial losses to Lakeland Electric under this contract. Management made a decision that losses related to the FMPA contract would not be passed along to the electric customers in the form of a fuel recovery. 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. The contract expired on December 14, 2007. A loss of $5.2 million was sustained during the final three months of the contract and is included in the results of operations for fiscal year 2008.

Lakeland Electric has active construction projects as of September 30, 2008. The projects include construction of a Selective Catalytic Reduction System for EPA compliance and substation construction projects. Commitments for major contracts not competed as of September 30, 2008 as follows:

Deep foundation installation for Selective Catalytic Reduction (SCR) system	$ 13,574,559
Design and engineering of SCR system	1,034,710
SCR catayst modules and Flow Test Modle Test	3,413,702
Rebuilding of the Westside Substation	2,041,453
Construction of Publix Substation and 69 KV supply	1,743,336

NOTE V - COMMITMENTS AND CONTINGENCIES (CONTINUED)

Encumbrances:
Lakeland Electric had outstanding purchase orders in the amount of $26,019,375 of September 30, 2008.

It is management's opinion that Lakeland Electric is in compliance with the requirements of all the aforementioned contractual commitments.

NOTE W – SUBSEQUENT EVENTS

In February of 2009, the City Commission amended the formula used to provide a post employment benefit designed to help pay a portion of medical costs incurred by retired employees. The revision to the formula converts the City's obligation from a percentage of the health insurance premium to a fixed dollar amount based on the retired employee's years of service during their tenure. This change had the effect of reducing the actuarial accrued liability associated with that explicit liability from $34,295,504 to $20,440,000. As a result of this change, the annual required contribution necessary to amortize the unfunded liability associate with this benefit will be fully funded from a 2% of payroll contribution deposited into the trust fund commencing in FY 2009.

In addition, the health insurance premiums charged for both active and retired employees were increased effective January 1, 2009. This change had the impact of reducing the actuarial accrued liability for the implicit subsidy by almost $4 million. That obligation will continue to be funded on a pay-as-you go basis.