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## **INDEPENDENT AUDITOR'S REPORT**

Utility Board of the City  
of Key West, Florida  
"Keys Energy Services"  
Key West, Florida

We have audited the accompanying financial statements of the Utility Board of the City of Key West, Florida, d/b/a Keys Energy Services, ("KEYS") as of and for the years ended September 30, 2007 and 2006, which collectively comprise KEYS' basic financial statements as listed in the table of contents. These financial statements are the responsibility of KEYS' management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Utility Board of the City of Key West, Florida, Keys Energy Services as of September 30, 2007 and 2006, and the changes in financial position, and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 15, 2008, on our consideration of KEYS' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial

reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis as listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise KEYS' basic financial statements. The introductory section and statistical section are presented for purposes of additional analysis and are not a required part of the basic financial statements. The introductory and statistical sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

  
OROPEZA & PARKS  
CERTIFIED PUBLIC ACCOUNTANTS

January 15, 2008

## Management's Discussion and Analysis

As management of the Utility Board of the City of Key West, Florida, we offer readers of the Utility Board's financial statements this narrative overview and analysis of the financial activities of the Utility Board of the City of Key West for the fiscal year ended September 30, 2007. We encourage readers to consider the information presented here in conjunction with additional information we have furnished in our Letter of Transmittal.

### Required Financial Statements

The financial statements consist of the Balance Sheet, Statement of Revenues, Expenses and Changes in Net Assets, and Statement of Cash Flows. The *Balance Sheet* provides information about the nature and amounts of investments in resources (assets) and the obligations to creditors (liabilities). It also provides the basis for assessing the liquidity and financial flexibility of the Utility. All of the current year's revenues and expenses are accounted for in the *Statement of Revenues, Expenses and Changes in Net Assets*. This statement reports all the revenues and expenses during the time periods indicated, and can be used to determine whether the Utility has successfully recovered all its costs. The primary purpose of the *Statement of Cash Flows* is to provide information about the Utility's cash receipts and cash payments. This statement reports cash receipts, cash payments, and net changes in cash resulting from activities related to operations, non-capital financing, and capital and related financing. The statement also provides answers to such questions as "where did cash come from?" "what was cash used for?" and "what was the change in cash balance during the reporting period?"

### Balance Sheet

The Utility's Net Assets, which do not include the negative net pension obligation, increased in Fiscal 2007 by \$3.0 million, or 4.1%.

	2005	2006	2007	2006 to 2007 Increase (Decrease)	
				Amount	Percent
Total Unrestricted Current Assets	\$25,045,203	\$25,176,463	\$25,433,245	\$256,782	1.0%
Total Restricted Current Assets	11,466,147	12,833,724	49,986,599	37,152,875	289.5%
Total Capital Assets	114,111,920	114,832,809	121,489,994	6,657,185	5.8%
Total Restricted Non-Current Assets	3,243,009	3,243,009	2,266,539	(976,470)	-30.1%
Total Unrestricted Non-Current Assets	8,678,118	8,746,958	9,094,311	347,353	4.0%
Total Assets	<u>\$162,544,397</u>	<u>\$164,832,963</u>	<u>\$208,270,688</u>	<u>\$43,437,725</u>	<u>26.4%</u>
Invested in Capital Assets, net of related debt	\$48,044,762	\$53,995,651	\$60,127,172	\$6,131,521	11.4%
Restricted for Working Capital	3,243,009	3,243,009	2,266,539	(976,470)	-30.1%
Unrestricted	15,830,949	15,934,969	13,775,810	(2,159,159)	-13.5%
Net Assets	<u>67,118,720</u>	<u>73,173,629</u>	<u>76,169,521</u>	<u>2,995,892</u>	<u>4.1%</u>
Long-Term Debt, Net of Current Portion	75,257,723	71,126,824	108,910,987	37,784,163	53.1%
Total Restricted Current Liabilities	11,200,080	11,998,052	13,223,134	1,225,082	10.2%
Total Unrestricted Current Liabilities	8,967,874	8,534,458	9,967,046	1,432,588	16.8%
Total Liabilities	<u>95,425,677</u>	<u>91,659,334</u>	<u>132,101,167</u>	<u>40,441,833</u>	<u>44.1%</u>
Total Net Assets and Liabilities	<u>\$162,544,397</u>	<u>\$164,832,963</u>	<u>\$208,270,688</u>	<u>\$43,437,725</u>	<u>26.4%</u>

The changes to Assets are listed as follows:

- Increase in Total Unrestricted Current Assets - \$256,782.
  - Decrease to Cash - \$2.2 million as a result of lower billings.
  - Increase to Customer Receivables - \$778,325 due to a change in billing cycles.
  - Increase to Other Receivables - \$214,456 additional billings to FMPA for repairs to generating units.
  - Decrease to Due from Other Governments - \$9,492 payments received from FEMA.
  - Increase to Inventory - \$700,623 inventory maximum levels were raised for the Storm Hardening Project and for hurricane season.
  - Increase Prepaid Expense - \$758,545 because of prepaying bond payments due on October 1<sup>st</sup>.
- Increase in Total Restricted Current Assets - \$37.1 million due to Series 2006 Bond Proceeds.
- Increase in Total Capital Assets - \$6.7 million.
  - Increase to Capital Assets – Net Utility Plant - \$11.5 million. The larger assets added to Utility Plant are as follows:
 

Distribution Improvements & Storm Hardening	\$ 2,220,000
Engineering Requests	\$ 1,300,000
Purchase Transformers	\$ 1,267,800
Purchase Meters	\$ 624,700
Replace Company Vehicles	\$ 502,200
Replace SI Sewer System	\$ 453,500
Daily Work Orders	\$ 432,800
  - Decrease to Capital Assets – Net Utility Plant - \$7.2 million. There were two major retirements during 2007. The two Cudjoe Key and the Big Pine Key peaking diesel units were retired at \$6.5 million.
  - Net Increase to Construction Work in Progress - \$2.4 million includes the following projects:
 

Distribution Improvement & Storm Hardening	\$ 522,297
Repairs to Synchronous Condenser	\$ 279,419
Replace 69KV Switches	\$ 276,135
Replace Transmission Oil Circuit Breakers	\$ 520,645
Upgrade Transmission Relay Panels	\$ 276,300
Replace & Upgrade SCADA System	\$ 147,858
Engineering Requests	\$ 115,000
- Decrease in Total Restricted Non-Current Assets - \$976,500 due to a return of working capital from FMPA.
- Increase in Total Unrestricted Non-Current Assets - \$347,353.
  - Increase in Other Accounts Receivable - \$179,400 (Long Term Receivable).
  - Increase in Bond Discount & Issue Costs - \$168,000 issuance costs associated with Series 2006 Bond.

The changes to Liabilities are listed as follows:

- Net Increase in Long Term Debt - \$37.8 million as a result of the annual fiscal year debt service payment and the Series 2006 Bond Issue.
- Increase in Current Liabilities - \$2.6 million due to higher accounts payable and increase in interest payable for Series 2006 bond.

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

Electric sales of 706.31 Gigawatt hours (GWh's) in Fiscal Year 2007 were higher than Fiscal Year 2006 sales of 704.1 GWh's, by 0.3%.

	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2006 to 2007 Increase (Decrease)</u>	
				<u>Amount</u>	<u>Percent</u>
Electric Revenues	\$80,406,201	\$93,968,368	\$90,080,391	(\$3,887,977)	-4.1%
Other Electric Revenues	3,072,535	3,231,697	3,668,481	436,784	13.5%
Total Operating Revenues	83,478,736	97,200,065	93,748,872	(3,451,193)	-3.6%
Production Expense - Diesel	1,074,167	1,482,077	1,623,810	141,733	9.6%
Purchased Power	49,287,046	59,946,424	58,531,619	(1,414,805)	-2.4%
Transmission Expenses	3,646,679	3,539,845	3,857,363	317,518	9.0%
Distribution Expenses	3,017,736	3,366,439	3,984,022	617,583	18.3%
Customer Accounts and Collection Expenses	1,280,590	1,243,322	1,332,355	89,033	7.2%
Administrative and General Expenses	11,540,112	11,452,519	11,812,589	360,070	3.1%
Depreciation	6,391,999	6,182,488	6,340,313	157,825	2.6%
Taxes Other Income Taxes	2,127,074	2,467,955	2,390,686	(77,269)	-3.1%
Total Operating Expenses	78,365,403	89,681,069	89,872,757	191,688	0.2%
Interest Income	613,525	1,047,716	2,032,958	985,242	94.0%
Grant Revenue	119,367	-	-	-	0.0%
Miscellaneous Non-Operating Revenue	753,622	2,255,168	1,398,741	(856,427)	-38.0%
Payment to City of Key West	(340,548)	(343,341)	(341,279)	2,062	-0.6%
Interest on Debt	(4,811,456)	(4,670,672)	(4,435,260)	235,412	-5.0%
Interest on Customer Deposit	(109,429)	(194,367)	(197,964)	(3,597)	1.9%
Amortization of Bond Discount and Issue Costs	(104,508)	(104,508)	(113,096)	(8,588)	8.2%
Total Non-Operating Revenue and (Expenses)	(3,879,427)	(2,010,004)	(1,655,900)	354,104	-17.6%
Income Before Special Items	1,233,906	5,508,992	2,220,215	(3,288,777)	-59.7%
Hurricane-Grant Revenue	1,900,702	3,281,600	550,209	(2,731,391)	-83.2%
Hurricane-Expenses	(2,214,686)	(3,094,972)	-	3,094,972	-100.0%
Hurricane-Insurance Proceeds	-	273,306	-	(273,306)	-100.0%
Sale Steam Plant	4,568,719	-	-	-	0.0%
Total Special Items	4,254,735	459,934	550,209	90,275	19.6%
Income Before Capital Contributions	5,488,641	5,968,926	2,770,424	(3,198,502)	-53.6%
Capital Contributions	119,347	85,983	225,468	139,485	162.2%
Change in Net Assets	5,607,988	6,054,909	2,995,892	(3,059,017)	-50.5%
Net Assets, Beginning of Year	61,510,732	67,118,720	73,173,629	6,054,909	9.0%
Net Assets, End of Year	\$ 67,118,720	\$ 73,173,629	\$ 76,169,521	\$ 2,995,892	4.1%

The Change in Net Assets was \$3.0 million in 2007. This was primarily due to:

- Decrease in Total Operating Revenues – \$3.5 million
  - Net Decrease in Electric Revenue and Power Cost Adjustment (PCA) - \$3.5 million is primarily a result of lower PCA revenues.
- Increase in Total Operating Expenses - \$191,688.
  - Increase of Production expenses - \$141,733 primarily due to an aggressive schedule of preventive maintenance for all generating units.
  - Decrease of Purchased Power Costs - \$1.4 million primarily due to lower usage.
  - Increase in Transmission expenses - \$317,518 is a result of a helicopter inspection and repairs to overhead lines.
  - Increase in Distribution expenses - \$617,583 largely due to increases in tree trimming expenses, transformer repairs, transformer painting, and equipment repair.
  - Increase in all other Operating Expenses - \$514,884 is due to a general rise in operating costs.

- Increase in Total Non-Operating Revenue & Expenses - \$354,104
  - Increase in Interest Income - \$985,242 due to higher interest rates.
  - Decrease in Miscellaneous Non-Operating Revenue - \$856,427 thousand Fiscal Year 2006 included many one time items.
  - Increase in the other Non-Operating Revenue & Expenses - \$225,289 is primarily due to lower interest on debt.
- Increase in Total Special Items - \$90,275 thousand is due to an increase in the reimbursement percentage by Federal Emergency Management Agency.
- Increase in Capital Contribution
  - Increase in Interest Income - \$985,242 due to higher interest rates.
  - Decrease in Other Income - \$3.8 million in Fiscal Year 2006 included many one time items.

### **Statement of Cash Flows**

The Utility's rate structure is designed to collect sufficient revenues to pay debt service and recover operating and maintenance expenses. The Utility successfully accomplished this objective during Fiscal Year 2007. The same situation held true for the prior fiscal year. Income before Capital Contributions decreased \$3.2 million primarily due a reduction in Hurricane Grant Revenue. The Utility increased net assets by \$3.0 million while paying down debt of \$6.5 million in principal and \$2.1 million in interest.

### **Restricted Assets**

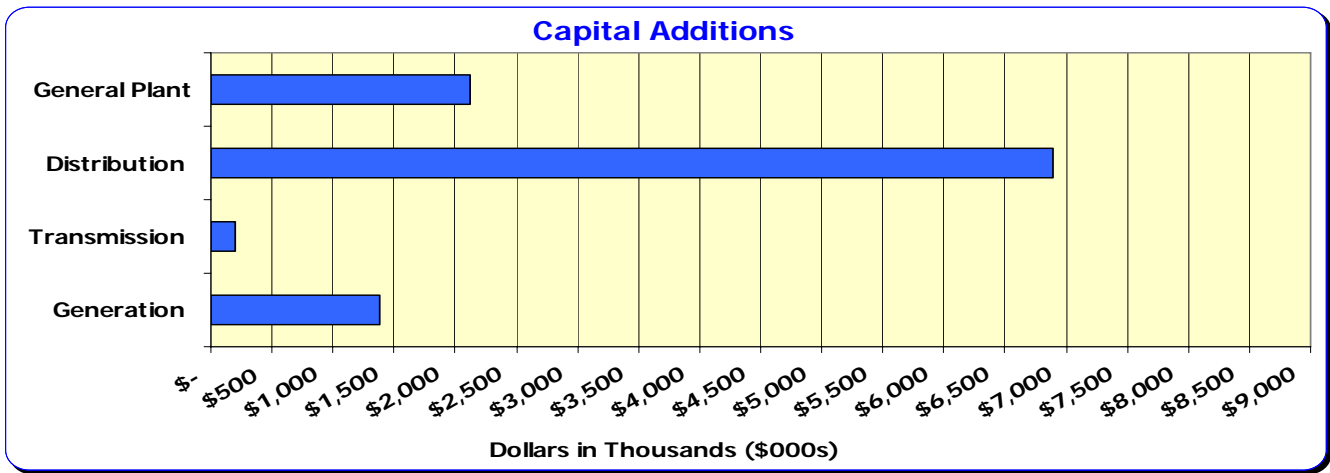
Total restricted assets were \$52.3 million at September 30, 2007, compared to \$16.0 million at September 30, 2006. The Utility's bond resolution specifies the manner in which monies on deposit in the various funds must be used. The Contribution in Aid of Construction Capital Fund is used for initial non-residential, commercial or large power service deposits related to transmission or distribution projects. The Customer Deposit Fund is used for residential and commercial deposits for basic electric service. The Emergency Reserve Fund is used to pay emergency repairs or replacements of capital assets which have been destroyed or damaged. The Rate Stabilization Fund is used to maintain flexibility with respect to future rate adjustments and to provide additional monies for anticipated capital improvements. The Renewal and Replacement Fund is used only for paying the cost of extensions, enlargements, replacements or additions to the capital assets of the Utility. The Sinking Fund is used only to pay principal and interest on Bonds as they mature and become due.

### **Significant Capital Assets**

Net Property, Plant and Equipment totaled \$121.5 million at the end of Fiscal 2007 compared to \$114.8 million the prior year, an increase of \$6.7 million which includes \$663,500 in capitalized interest.

Significant projects placed in service were Distribution Improvements & Storm Hardening, Purchase of Transformers, Replacement of Company Vehicles, Repairs to Generating Units, Engineering Requests, Replacement of Stock Island Sewer System, Purchase of Meters, Replacement of SCADA System, and Computer Conversion, Repairs and Equipment. Please see Note 1 in Notes to Financial Statements for further information.

Capital additions are illustrated in the following graph:



**Long Term Debt**

The Utility’s trustee will pay to the bondholders a principal payment of \$5.8 million on October 1, 2007. In accordance with the Bond covenants, monthly transfers are made from the Revenue Fund to the Sinking Fund, which are reflected on the balance sheet as Other Property and Investments - “restricted assets.” The bondholders are paid annual principal payments on October 1 and semiannual interest payments on April 1<sup>st</sup> and October 1<sup>st</sup> of each year.

In anticipation of a Florida Public Service Commission ruling that will compel utilities to storm harden their infrastructure KEYS’ has taken steps to meet this requirement. On October 31, 2006, KEYS issued \$42.0 million of Electric System Refunding and Capital Improvement Revenue Bonds, Series 2006. The bonds refunded the FMPA loan of \$948,000 and will fund several capital projects, including a pole hardening program, transmission and distribution improvements, a new substation located in Stock Island, installation of new feeders at the Big Pine substation, replacement of certain substation transformers and installation of fin fan coolers at the Stock Island Generating Facilities. The issue is rated AAA by Standard & Poor’s (S&P) and Fitch and Aaa by Moody’s and is insured by the MBIA Insurance Company. In addition, KEYS obtained an underlying bond rating of A2 from Moody’s and A- from S&P. The Utility’s debt service payments have been structured to remain fairly constant at approximately \$8.5 million through 2014, \$9.3 million through 2018 and \$4.4 million from 2019 through 2031. Please see Note 5 in Notes to Financial Statements for further information.

**Summary**

This report is intended to provide our customers, bondholders, and other interested parties with a general overview of the financial position of the Utility Board of the City of Key West and to indicate accountability for the revenues received. Questions about this report or requests for additional information should be directed to the Assistant General Manager & Chief Financial Officer, 305-295-1013, or to our offices located at 1001 James Street, Key West, Florida 33040.

**UTILITY BOARD OF THE CITY OF KEY WEST, FLORIDA**

**BALANCE SHEETS**

**SEPTEMBER 30, 2007 AND 2006**

ASSETS

	<u>2007</u>	<u>2006</u>
<b>Current Assets</b>		
Cash and Cash Equivalents	\$ 4,878,731	\$ 7,064,406
Customer Accounts Receivable, net of Allowance for Bad Debts of \$237,910 and \$263,331 for FY 07 and FY 06 respectively	6,930,502	6,152,177
Other Accounts Receivable	709,585	495,129
Due From Other Governments	814,429	823,921
Plant Material and Operating Supplies Inventory	3,422,943	2,722,320
Prepaid Expenses	<u>8,677,055</u>	<u>7,918,510</u>
 Total Unrestricted Current Assets	 25,433,245	 25,176,463
 Cash and Cash Equivalents-Restricted	 49,983,884	 12,833,724
Interest Receivable	<u>2,715</u>	<u>-</u>
 Total Restricted Currents Assets	 49,986,599	 12,833,724
 <b>Total Current Assets</b>	 <u>75,419,844</u>	 <u>38,010,187</u>
 <b>Non-Current Assets</b>		
Capital Assets		
Utility Plant	198,055,864	196,142,287
Less Accumulated Depreciation	<u>80,123,937</u>	<u>82,465,916</u>
Net Utility Plant	117,931,927	113,676,371
Construction in Progress	<u>3,558,067</u>	<u>1,156,438</u>
 Total Capital Assets	 121,489,994	 114,832,809
 Restricted Non-Current Assets		
Deposits-Restricted	<u>2,266,539</u>	<u>3,243,009</u>
 Total Restricted Non-Current Assets	 2,266,539	 3,243,009
 Unrestricted Non-Current Assets		
Other Accounts Receivable	8,121,582	7,942,212
Bond Discount and Issue Costs, Net	<u>972,729</u>	<u>804,746</u>
 Total Unrestricted Non-Current Assets	 <u>9,094,311</u>	 <u>8,746,958</u>
 <b>Total Non-Current Assets</b>	 <u>132,850,844</u>	 <u>126,822,776</u>
 <b>Total Assets</b>	 <u>\$ 208,270,688</u>	 <u>\$ 164,832,963</u>

(Continued)

(Continued)

The accompanying notes are an integral  
part of these financial statements.

**UTILITY BOARD OF THE CITY OF KEY WEST, FLORIDA**

**BALANCE SHEETS (CONTINUED)**

**SEPTEMBER 30, 2007 AND 2006**

NET ASSETS AND LIABILITIES

	<u>2007</u>	<u>2006</u>
<b>Current Liabilities</b>		
Unrestricted Current Liabilities		
Accounts Payable	\$ 6,685,677	\$ 5,709,921
Accrued Expenses	3,149,004	2,508,409
Deferred Revenues	132,365	316,128
	<hr/>	<hr/>
Total Unrestricted Current Liabilities	9,967,046	8,534,458
Restricted Current Liabilities		
Current Portion of Long-Term Debt	5,694,373	5,454,373
Accounts Payable	744,959	914,510
Accrued Interest	2,342,556	1,498,275
Accrued Costs FMPA	205,950	-
Security Deposits Payable	110,000	110,000
Due to Customers	4,125,296	4,020,894
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Total Restricted Current Liabilities	13,223,134	11,998,052
	<hr/>	<hr/>
<b>Total Current Liabilities</b>	23,190,180	20,532,510
<b>Long-Term Debt, Net of Current Portion</b>		
Revenue Bonds	92,091,536	55,032,256
Accrued Interest	16,819,451	15,146,568
Loan Payable	-	948,000
	<hr/>	<hr/>
<b>Total Long-Term Debt</b>	108,910,987	71,126,824
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<b>Total Liabilities</b>	132,101,167	91,659,334
	<hr/>	<hr/>
<b>Net Assets</b>		
Invested in Capital Assets		
net of related debt	60,127,172	53,995,651
Restricted for Working Capital	2,266,539	3,243,009
Unrestricted	13,775,810	15,934,969
	<hr/>	<hr/>
<b>Total Net Assets</b>	76,169,521	73,173,629
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<b>Total Net Assets and Liabilities</b>	\$ 208,270,688	\$ 164,832,963
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The accompanying notes are an integral part of these financial statements.

**UTILITY BOARD OF THE CITY OF KEY WEST, FLORIDA**

**STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN NET ASSETS**

**FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006**

	<u>2007</u>	<u>2006</u>
<b>Operating Revenues</b>		
Sales & Charges for Service	\$ 91,046,879	\$ 94,831,374
Other Operating Revenues	2,701,993	2,368,691
<b>Total Operating Revenues</b>	<u>93,748,872</u>	<u>97,200,065</u>
<b>Operating Expenses</b>		
Production Expenses - Diesel	1,623,810	1,482,077
Purchased Power	58,531,619	59,946,424
Transmission Expenses	3,857,363	3,539,845
Distribution Expenses	3,984,022	3,366,439
Customer Accounts and Collection Expenses	1,332,355	1,243,322
Administrative and General Expenses	11,812,589	11,452,519
Depreciation	6,340,313	6,182,488
Taxes Other than Income Taxes	2,390,686	2,467,955
<b>Total Operating Expenses</b>	<u>89,872,757</u>	<u>89,681,069</u>
<b>Operating Income</b>	<u>3,876,115</u>	<u>7,518,996</u>
<b>Non-Operating Revenue and (Expenses)</b>		
Interest Income	2,032,958	1,047,716
Miscellaneous Non-Operating Revenue	1,398,741	2,255,168
Payment to City of Key West	(341,279)	(343,341)
Interest on Debt	(4,435,260)	(4,670,672)
Interest on Customer Deposit	(197,964)	(194,367)
Amortization of Bond Discount and Issue Costs	(113,096)	(104,508)
<b>Total Non-Operating Revenue and (Expenses)</b>	<u>(1,655,900)</u>	<u>(2,010,004)</u>
<b>Income Before Special Items</b>	<u>2,220,215</u>	<u>5,508,992</u>
<b>Special Items</b>		
Hurricane-Grant Revenue	550,209	3,281,600
Hurricane-Expenses	-	(3,094,972)
Hurricane - Insurance Proceeds	-	273,306
<b>Total Special Items</b>	<u>550,209</u>	<u>459,934</u>
<b>Income Before Capital Contributions</b>	<u>2,770,424</u>	<u>5,968,926</u>
<b>Capital Contributions</b>	<u>225,468</u>	<u>85,983</u>
<b>Change in Net Assets</b>	2,995,892	6,054,909
<b>Net Assets, Beginning of Year</b>	<u>73,173,629</u>	<u>67,118,720</u>
<b>Net Assets, End of Period</b>	<u>\$ 76,169,521</u>	<u>\$ 73,173,629</u>

The accompanying notes are an integral part of these financial statements.

**UTILITY BOARD OF THE CITY OF KEY WEST, FLORIDA**

**STATEMENTS OF CASH FLOWS**

**FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006**

	<u>2007</u>	<u>2006</u>
<b>Cash Flows Provided (Used) by Operating Activities</b>		
Cash Received from Customers	\$ 92,789,776	\$ 96,550,156
Cash Payments to Suppliers for Goods and services	(74,820,475)	(76,347,419)
Cash Payments for Restricted Working Capital Deposits	976,470	-
Cash Payments to Employees for Services	(8,561,891)	(8,142,697)
Cash Received for Deposits	1,112,001	871,306
Cash Deposits Refunded	(1,007,599)	(934,640)
Cash Received from Other Operating revenue	1,214,978	2,489,010
Cash Received for Hurricane	<u>559,701</u>	<u>1,263,409</u>
<b>Net Cash Provided by Operating Sources</b>	\$ 12,262,961	\$ 15,749,125
<b>Cash Flows Provided (Used) by Non-Capital Financing Activities</b>		
Cash Received from Insurance Proceeds	-	273,306
Cash Paid to City of Key West, Florida	<u>(341,279)</u>	<u>(343,341)</u>
<b>Net Cash (Used) by Non-Capital Financing Activities</b>	<u>(341,279)</u>	<u>(70,035)</u>
<b>Cash Flows Provided (Used) by Capital and Related Financing Activities</b>		
Bond Proceeds	42,753,654	-
Issues Costs	(281,079)	-
Principal Paid on Long-Term Debt	(6,463,000)	(5,467,000)
Interest Paid on Revenue Bond Maturities	(2,055,434)	(3,385,486)
Contributions in Aid of Construction	225,468	85,983
Acquisitions and Construction of Capital Assets	(13,168,414)	(6,303,685)
Proceeds (costs) from Disposal of Assets	<u>1,365</u>	<u>118,162</u>
<b>Net Cash Provided (Used) by Capital and Related Financing Activities</b>	<u>21,012,560</u>	<u>(14,952,026)</u>
<b>Cash Flows Provided (Used) by Investing Activities</b>		
Interest Received on Investments	<u>2,030,243</u>	<u>1,047,716</u>
<b>Net Cash Provided by Investing Activities</b>	<u>2,030,243</u>	<u>1,047,716</u>
<b>Net Increase in Cash and Cash Equivalents</b>	34,964,485	1,774,780
<b>Cash and Cash Equivalents at Beginning of year</b>	<u>19,898,130</u>	<u>18,123,350</u>
<b>Cash and Cash Equivalents at End of Year</b>	<u>\$ 54,862,615</u>	<u>\$ 19,898,130</u>

The accompanying notes are an integral part of these financial statements.

**UTILITY BOARD OF THE CITY OF KEY WEST, FLORIDA**  
**STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006**

Reconciliation of Operating Income to  
Net Cash Provided by Operating Activities

	<b>2007</b>	<b>2006</b>
<b>Operating Income</b>	<b>\$ 3,876,115</b>	<b>\$ 7,518,996</b>
<b>Adjustments to Reconcile Operating Income to Net Cash Provided by  Operating Activities</b>		
Depreciation	6,340,313	6,182,488
Provision for Uncollectible Accounts	196,117	238,648
Amortization of Deferred Revenue	(316,128)	(82,286)
Receipt of Deferred Revenue	132,365	316,128
Other Non-Operating Sources of Revenue	1,398,741	2,255,168
Hurricane Revenue	550,209	186,628
<b>Changes in Assets and Liabilities</b>		
(Increase) Decrease in Restricted Working Capital Deposit	976,470	-
(Increase) Decrease in Long Term Debt	-	-
(Increase) Decrease in Accounts Receivable	(1,368,268)	(836,954)
(Increase) Decrease in Plant Material & Inventory	(700,623)	(267,515)
(Increase) Decrease in Prepaid Expenses	(758,545)	(108,365)
(Increase) Decrease in Due from Other Governments	9,492	1,076,781
Increase (Decrease) in Accounts Payable	1,181,706	(1,041,855)
Increase (Decrease) in Accrued Expenses	640,595	374,597
Increase (Decrease) in Customer Deposits	104,402	(63,334)
Increase (Decrease) in Security Deposits	-	-
<b>Total Adjustments</b>	<b>8,386,846</b>	<b>8,230,129</b>
<b>Net Cash Provided by Operating Activities</b>	<b>\$ 12,262,961</b>	<b>\$ 15,749,125</b>

Supplemental Schedule of Non-Cash Financing, Capital and Investing Activities

In 2007 and 2006, amortization of bond discount and issue costs were \$113,096 and \$104,508, respectively.

The accompanying notes are an integral  
part of these financial statements.

UTILITY BOARD OF THE CITY OF KEY WEST, FLORIDA

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accounting policies and the presentation of the financial report of the Utility Board of the City of Key West, Florida "Keys Energy Services" (KEYS) have been designed to conform to generally accepted accounting principles as applicable to governmental units, in accordance with the Governmental Accounting Standards Board (GASB). The GASB embodies the official pronouncements previously issued by the National Council on Governmental Accounting (NCGA). KEYS applies Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, in which case, GASB prevails. The following is a summary of the significant accounting policies.

**Entity Definition** - KEYS was created by an Act of the Florida Legislature to manage, operate and maintain the electric utility servicing the citizens of the City of Key West, Florida (the City) and the lower Florida Keys. KEYS is the successor of the electric public utility once owned by the City and was given all powers and rights necessary to manage, operate, maintain, control, and extend the electric utility property owned by the City of Key West at the time of its creation. The Board is composed of a Chairman who is elected every four years and four members who are elected every four years by the voters of the City. The members select the chairman during the Organizational Meeting following an election. This became effective in January 2007. The General Manager & CEO of KEYS serves as Secretary to the Board and is responsible for the day-to-day operations of KEYS. KEYS is not a component unit of the City.

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

**Basis of Accounting** - KEYS' financial statements are accounted for based on accounting required by the Federal Energy Regulatory Commission (FERC), which is an application of generally accepted accounting principles that is peculiar to utilities. Revenues are recognized in the period earned and expenses are recognized in the period incurred, regardless of the timing of the related cash flows.

**Budget** - In accordance with KEYS' enabling Legislation, the Utility Board holds public hearings and subsequently adopts an annual budget for operating expenses and capital outlay. Actual revenues and expenses are compared to the budget on a line item basis (which is the legal level of control) within cost centers and an analysis of variances report is prepared and submitted to the Utility Board each month as required by bond indentures. During the year, staff can make amendments within the operating budget or the capital budget that do not change the total budget for those categories. The Utility Board approves all other budget changes. Supplemental appropriations were necessary during FY07 and the Utility Board, in accordance with KEYS' policies, amended the budgetary data presented herein. Budget appropriations lapse at each fiscal year-end except for the Capital Budget. The budget is adopted on a basis consistent with KEYS' basis of accounting except for depreciation and amortization, debt service on revenue bonds and allocation of administrative costs to capital projects.

**UTILITY BOARD OF THE CITY OF KEY WEST, FLORIDA**

**NOTES TO FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Cash and Investments** - Cash and investments in U.S. Government Securities are recorded at cost or amortized cost. Amortized cost does not significantly vary from market value. Any other investments are stated at fair value in accordance with GASB 31. Florida Statutes govern KEYS' investment policies. These policies are described in more detail in Note 3.

**Revenue** - Revenue is recognized based on monthly route billings to customers. Revenue is not accrued for services supplied but unbilled at the end of the fiscal period. Charges for new service are reported as revenue only to the extent of connection costs, while amounts exceeding this cost are recorded as contributed capital revenue.

**Bond Discount and Issue Costs** - Bond discount and issue costs consist of debt issue costs, original issue discounts, and underwriter discounts, which are capitalized and amortized over the term of the related indebtedness.

**Property, Plant and Equipment** - Property, Plant and Equipment is stated at cost. Transmission, Distribution and Generation Plant are defined by KEYS as assets with an initial, individual cost of \$5,000 or more and an estimated useful life of more than one year. General Plant assets are defined as assets with an initial, individual cost of \$1,000 or more and an estimated useful life of more than one year. Under FERC accounting practices and procedures, the cost of electric plant retired, together with removal costs less salvage, is charged to accumulated depreciation when property is removed from service.

The following is a summary of property, plant and equipment for the year ended September 30, 2007:

	<b>Balance 2006</b>	<b>Additions</b>	<b>Deletions</b>	<b>Balance 2007</b>
Utility Plant in Service:				
Generation Plant	\$ 50,683,391	\$ 1,382,251	\$ (5,991,011)	\$ 46,074,631
Transmission Plant	72,481,155	203,550	(21,059)	\$ 72,663,646
Distribution Plant	58,162,357	6,886,820	(1,253,707)	\$ 63,795,470
General Plant	14,595,120	2,124,613	(1,417,880)	\$ 15,301,853
Other	220,264	-	-	\$ 220,264
Total Utility Plant in Service	<u>196,142,287</u>	<u>10,597,234</u>	<u>(8,683,657)</u>	<u>198,055,864</u>
Accumulated Depreciation:				
Generation Plant	(27,727,274)	(1,723,752)	6,063,119	(23,387,907)
Transmission Plant	(28,147,536)	(1,775,688)	47,872	(29,875,352)
Distribution Plant	(20,083,103)	(1,885,283)	1,216,138	(20,752,248)
General Plant	(6,508,003)	(955,589)	1,355,162	(6,108,430)
Other	-	-	-	-
Total Accumulated Depreciation	<u>(82,465,916)</u>	<u>(6,340,312)</u>	<u>8,682,291</u>	<u>(80,123,937)</u>
<b>Net Utility Plant in Service</b>	<u><b>\$ 113,676,371</b></u>	<u><b>\$ 4,256,922</b></u>	<u><b>\$ (1,366)</b></u>	<u><b>\$ 117,931,927</b></u>
Construction Work in Progress	<u><b>\$ 1,156,438</b></u>	<u><b>\$ 12,998,863</b></u>	<u><b>\$(10,597,234)</b></u>	<u><b>\$ 3,558,067</b></u>

**UTILITY BOARD OF THE CITY OF KEY WEST, FLORIDA**

**NOTES TO FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

KEYS' policy concerning capitalized interest costs is in accordance with Statement of Financial Accounting Standards No. 62, which requires the capitalization of interest costs of restricted tax-exempt borrowings less any interest earned on investment funds during the construction period. For the fiscal years ended September 30, 2007 and 2006, interest costs of \$663,505 thousand and \$0, respectively were capitalized as utility plant construction costs which is detailed below.

	<u>2007</u>	<u>2006</u>
Interest Expense	\$ 1,828,389	\$ -
Amortization of Issue Premium	<u>(23,754)</u>	<u>-</u>
	1,804,635	-
Interest Earnings	<u>(1,141,130)</u>	<u>-</u>
<b>Net Interest Costs Capitalized</b>	<b><u><u>\$ 663,505</u></u></b>	<b><u><u>\$ -</u></u></b>

Property, Plant and Equipment is depreciated using the straight-line method at rates which will amortize costs over the estimated useful lives of the assets. The estimated useful lives of the electric plant assets are as follows:

Generation Plant	25 Years
Transmission Plant	31 - 45 Years
Distribution Plant	20 - 45 Years
General Plant	5 - 40 Years

**Inventory** - Inventories are stated at the lower of cost (determined on an average cost basis) or market.

**Compensated Absences** - KEYS records compensation for unused vacation and sick leave as an expense in the year in which the vacation and sick leave is earned in accordance with GASB Statement No. 16. At September 30, 2007, annual vacation leave earned but not taken is \$423,657 and sick leave accumulated but not taken is \$858,882. During the next year \$13,014 vacation leave and \$85,055 sick leave will be due based on notification received from employees who intend to retire within the next year.

	<b>Balance 2006</b>	<b>Increases</b>	<b>Decreases</b>	<b>Balance 2007</b>
Vacation Leave	\$ 413,346	\$ 58,664	\$ (48,353)	\$ 423,657
Sick Leave	769,156	203,035	(113,309)	858,882
<b>Total</b>	<b><u><u>\$ 1,182,502</u></u></b>	<b><u><u>\$ 261,699</u></u></b>	<b><u><u>\$ (161,662)</u></u></b>	<b><u><u>\$ 1,282,539</u></u></b>

**UTILITY BOARD OF THE CITY OF KEY WEST, FLORIDA**

**NOTES TO FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006**

**NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**

**Operating Revenues and Expenses** – Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the KEYS principal ongoing operations. The principal operating revenues of KEYS are charges to customers for sales and services.

Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

**Interest** - Interest for the years ended September 30, 2007 and 2006 is summarized as follows:

	<u>2007</u>	<u>2006</u>
Electric Refunding Revenue Bonds, Series 1991	\$ 1,672,883	\$ 1,560,475
Electric Forward Refunding Revenue Bonds, Series 2000	2,370,238	2,635,599
Electric Forward Refunding Revenue Bonds, Series 2001	326,300	360,950
Revenue Bonds, Series 1980c	5,213	-
Series 2001 Loss on Refunding	60,626	60,627
Interest on Customer Deposits	197,964	194,367
FMPA Pooled Loan	-	53,021
<b>Total Interest Expense</b>	<b><u>\$ 4,633,224</u></b>	<b><u>\$ 4,865,039</u></b>

**Use of Estimates** – The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures/expenses during the reporting period. Actual results could differ from those estimates.

**Net Assets** – Equity is classified as net assets and displayed in three components:

Invested in Capital Assets, net of related debt – Consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds that are attributable to the acquisition, construction, or improvement of those assets.

Restricted for Working Capital – Consists of a restricted working capital deposit required by FMPA for participation in the All Requirements Project.

Unrestricted – All other net assets that do not meet the definition of “restricted for debt service” or “invested in capital assets, net of related debt.” For the years ended September 30, 2007 and 2006, the board has designated \$1.6 million and \$1.2 million respectively, for certain future repair and replacement costs.

**Income Taxes** - No provision for income taxes is reflected in the financial statements as KEYS is considered a unit of local government.

**UTILITY BOARD OF THE CITY OF KEY WEST, FLORIDA**

**NOTES TO FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006**

**NOTE 2 – OTHER PROPERTY AND INVESTMENTS**

**Restricted Assets** - Certain assets consisting of cash, cash equivalents and investments are restricted by bond resolutions; additionally, some assets have been classified as restricted in accordance with FERC. KEYS is required by revenue bond covenants to maintain a debt service reserve account in the amount of its highest debt service, which requirement is satisfied by a debt surety bond.

KEYS' Restricted Assets as of September 30, 2007 and 2006, respectively consist of the following:

	<u>2007</u>	<u>2006</u>
Emergency Reserve Fund	\$ 2,000,000	\$ 2,000,000
Contributions in Aid of Construction Fund	321,457	215,922
Renewal and Replacement Fund	140,242	2,606,517
Rate Stabilization Fund	4,602,882	3,925,074
Customer Deposits Fund	4,188,597	4,086,211
Construction Fund	37,730,701	-
Sinking Fund	5	-
Operating Reserve Fund	1,000,000	-
<b>Total</b>	<b><u>\$ 49,983,884</u></b>	<b><u>\$ 12,833,724</u></b>

**Restricted Deposits**- Florida Municipal Power Agency (FMPA) has required a working capital contribution. As of September 30, 2007 and 2006, the deposit balance was at \$2,266,539 and \$3,243,009 respectively. FMPA returned \$976,470 during the fiscal year.

**NOTE 3 – CASH, CASH EQUIVALENTS, AND INVESTMENTS**

KEYS' cash and cash equivalents as of September 30, 2007 and 2006, respectively consist of the following:

	<u>2007</u>	<u>2006</u>
Cash	\$ 37,871,085	\$ 9,060,491
Cash Equivalents		
Repurchase agreements	4,884,522	10,837,639
Local Government Surplus Fund	12,107,008	-
<b>Total cash and cash equivalents</b>	<b><u>\$ 54,862,615</u></b>	<b><u>\$ 19,898,130</u></b>

All cash and cash equivalents are fully liquid. The Local Government Surplus Fund, created by Section 218.405, Florida Statutes, is an investment pool operated by the Florida State Board of Administration. It is administered by the State Board of Administration, under the regulatory oversight of the State of Florida, Chapter 19-7 of the Florida Administrative Code. In November 2007 it was determined that all deposits with the Florida State Board of Administration be closed and the funds transferred to a local institution. Please see Note 17 for further information.

UTILITY BOARD OF THE CITY OF KEY WEST, FLORIDA

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006

**NOTE 3 – CASH, CASH EQUIVALENTS, AND INVESTMENTS (Continued)**

State Statutes govern KEYS' investment policies. In addition, KEYS has its own investment practices. Monies must be deposited in banks designated as qualified public depositories by the State of Florida, Department of Insurance and Treasurer. Permissible investments include the obligations of the U.S. Treasury and U.S. agencies, certificates of deposit, commercial paper, repurchase agreements, and other securities meeting KEYS' criteria for risk and return.

Collateral is provided for demand deposits and certificates of deposit through the Florida Security for Public Deposits Act. This Act established guidelines for qualification and participation by banks and savings associations, procedures for the administration of the collateral requirements and characteristics of eligible collateral. Under the Act, the qualified public depository must pledge at least 50% of the average daily balance for each month of all public deposits in excess of any applicable deposit insurance.

Additional collateral, up to a maximum of 125%, may be required if deemed necessary under the conditions set forth in the Act. Eligible collateral consists of obligations of the United States and its agencies and obligations of states and their political subdivisions, and unaffiliated corporations.

Obligations pledged to secure deposits must be delivered to the State Treasurer or, with the approval of the State Treasurer, to a bank, savings association, or trust company provided a power of attorney is delivered to the Treasurer.

On a monthly basis, the State Treasurer determines that the collateral has a market value adequate to cover the deposits under the provisions of the Act. For purposes of the statement of cash flows, KEYS considers all liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents.

Interest Rate Risk – As a means of limiting its exposure to fair value losses arising from rising interest rates KEYS investment policy limits its portfolio to maturities of no more than five years unless matched to a specific cash flow.

Credit Risk – KEYS general investment policy is to apply the prudent person rule: investments are made as a prudent person would be expected to act, with discretion and intelligence, to seek reasonable income, preserve capital and, in general avoid speculative investments. KEYS investment policy allows investments in U. S. Treasury, U. S. Agencies, and any U. S. state, certificates of deposits, repurchase agreements, and units of participation in the State of Florida Local Government Surplus Trust Fund.

In addition to these, KEYS also allows investment in commercial paper which is rated at the time of purchase in the single highest classification by Moody's and S&P and does not mature more than 270 calendar days after the date of purchase and agreements with a bank or insurance company which has an unsecured, uninsured and unguaranteed obligation (or claims-paying ability) rated "A3" or better by Moody's and a rating of "A-" or better by Standard & Poor's.

**UTILITY BOARD OF THE CITY OF KEY WEST, FLORIDA**

**NOTES TO FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006**

**NOTE 3 – CASH, CASH EQUIVALENTS, AND INVESTMENTS (Continued)**

Custodial Credit Risk – Custodial credit risk is the risk that in the event of a bank failure, KEYS deposits may not be returned. KEYS’ does not have a deposit policy for custodial risk. As of September 30, 2007 and 2006, the bank balances were \$55,422,756 and \$20,076,767 respectively. The bank balances were covered by federal depository insurance and for the amount in excess of such federal depository insurance, by the State of Florida’s Security of Public Deposits Act. The Act requires each qualified public depository to deposit with the State Treasurer eligible collateral equal to or in excess of the required collateral as determined by the provisions of the Act. In the event of a failure by a qualified public depository, losses in excess of federal depository insurance and proceeds from the sale of securities pledged by the depository are assessed against the other qualified public depositories of the same type as the depository in default.

**NOTE 4 – NON-CURRENT ASSETS**

Other Receivable – The Key West Steam Plant was decommissioned in 1991. In Fiscal Year 2005 the developer received all the permitting and financing to begin construction to redevelop the Steam Plant site. The Utility Board executed two 99-year lease agreements in 2005: one with Steam Plant Condominiums, LLC for 19 luxury condominiums, and one with Old Town Key West Development, LLC for 38 affordable housing units. Due to four hurricanes in 2005, the completion date has been extended to 2008 for both housing projects.

The four long-term lease receivables totaling \$8,121,582 are as follows:

- 1) The base rent of the luxury units for \$6,444,290 payments begin at the end of construction.
- 2) The initial rent of \$500,000 due 42 months after execution of lease.
- 3) The percentage rent of luxury units of \$1,177,205 with a percentage due after sale and/or occupancy of unit.
- 4) The affordable rent of \$87 due at the end of construction.

Summary of Lease Receivable is as follows:

<u>Year</u>	<u>Receivable</u>		
2008	\$ 1,968,697		
2009	94,670		
2010	93,700		
2011	92,740	Lease Receivable - Current	-
2012	91,790		
2013-2104	5,779,985	Lease Receivable - Long Term	8,121,582
	<u>\$ 8,121,582</u>	<b>Total Lease Receivable</b>	<u>\$ 8,121,582</u>

**UTILITY BOARD OF THE CITY OF KEY WEST, FLORIDA**

**NOTES TO FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006**

**NOTE 5 – LONG-TERM DEBT**

Net Revenues, as defined for purposes of bond security, is all income or earnings derived from the operation of KEYS, except Capital Improvement Charges, investment earnings on Construction and Bond Amortization Funds, and transfers to the Rate Stabilization Fund, less costs of operation and maintenance which do not include capital expenditures, extraordinary repairs, amortization of the costs of issuance of debt obligations, payments under Unconditional Output Contracts, or depreciation. See Note 7 for the rate covenant pertaining to revenues.

**Summary of Debt Service Funding Requirements to Maturity**

<b><u>Payment 12 mos ending October 1,</u></b>	<b><u>Principal</u></b>	<b><u>Interest</u></b>	<b><u>Total</u></b>
2008	\$ 6,005,000	\$ 4,370,488	\$ 10,375,488
2009	\$ 6,340,000	\$ 4,040,881	10,380,881
2010	\$ 6,695,000	\$ 3,678,069	10,373,069
2011	\$ 7,090,000	\$ 3,293,431	10,383,431
2012	\$ 7,495,000	\$ 2,885,906	10,380,906
2013 - 2017	\$ 14,611,543	\$ 40,795,463	55,407,006
2018- 2022	\$ 11,796,242	\$ 17,156,796	28,953,038
2023- 2027	\$ 15,915,000	\$ 6,192,388	22,107,388
2028- 2031	\$ 15,680,000	\$ 2,007,500	17,687,500
<b>Total</b>	<b><u>\$ 91,627,785</u></b>	<b><u>\$ 84,420,922</u></b>	<b><u>\$ 176,048,707</u></b>
2007	<u>5,755,000</u>		
	<b><u>\$ 97,382,785</u></b>		
Deferred Loss, series 2001	(350,530)		
Premium, series 2006	753,654		
<b>Total</b>	<b><u>\$ 97,785,909</u></b>		

Prior to the due date of each series of revenue bonds, KEYS is required to set aside sufficient funds to retire the matured principal amounts in equal, monthly amounts.

Changes in Long-Term Debt during Fiscal Year 2007 are as follows:

	<b><u>September 30, 2006</u></b>	<b><u>Additions</u></b>	<b><u>Retired</u></b>	<b><u>September 30, 2007</u></b>
Series 1991	\$ 8,077,785	\$ -	\$ -	\$ 8,077,785
Series 2000	44,530,000	-	4,615,000	39,915,000
Series 2001, net	7,878,844	-	839,374	7,039,470
Series 2006, net	-	42,777,408	23,754	42,753,654
FMPA	948,000	-	948,000	-
<b>Total</b>	<b><u>\$ 61,434,629</u></b>	<b><u>\$ 42,777,408</u></b>	<b><u>\$ 6,426,128</u></b>	<b><u>\$ 97,785,909</u></b>

**UTILITY BOARD OF THE CITY OF KEY WEST, FLORIDA**

**NOTES TO FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006**

**NOTE 5 – LONG-TERM DEBT (Continued)**

**Revenue Bonds:**

Electric System Refunding Revenue Bonds, Series 1991, collateralized by Net Revenues and certain Reserve Funds, payable October 1, 2014 to October 1, 2018 in installments of various amounts, bearing interest at rates from 7.05% to 7.10%.

	<u>2007</u>	<u>2006</u>
	\$ 8,077,785	\$ 8,077,785

Electric System Refunding Revenue Bonds, Series 2000, collateralized by Net Revenues and certain Reserve Funds, payable October 1, 2007 to October 1, 2013 in installments of various amounts, bearing interest at rates from 5.75% to 6.00%.

	39,915,000	44,530,000
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Electric System Refunding Revenue Bonds, Series 2001, collateralized by Net Revenues and certain Reserve Funds, payable October 1, 2007 to October 1, 2013 in installments of various amounts, bearing interest at rates from 3.70% to 4.62%.

	7,390,000	8,290,000
--	-----------	-----------

Deferred Loss on Refunding-net, amortized on the straight line basis over the term of the Series 2001 Revenue Bonds

	(350,530)	(411,156)
--	-----------	-----------

Series 2001, net

	<u>7,039,470</u>	<u>7,878,844</u>
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Electric System Refunding and Capital Improvement Revenue Bonds, Series 2006, collateralized by Net Revenues and certain Reserve Funds, payable October 1, 2019 to October 1, 2031 in installments of various amounts, bearing interest at rates from 4.0% to 5.0%

	42,000,000	-
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Net Original Premium, amortized on the straight line basis over the term of the Series 2006 Refunding and Capital Improvement Bonds

	753,654	
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Series 2006, net

	<u>42,753,654</u>	<u>-</u>
--	-------------------	----------

**Loan Payable:**

Loan from the Florida Municipal Power Agency, collateralized by a lien upon and pledge of the Net Revenues of KEYS subordinate to the claims of KEYS' bonds on the Net

	-	948,000
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**Total Long-Term Debt**

	<b>97,785,909</b>	<b>61,434,629</b>
--	-------------------	-------------------

Less Current Portion

	5,694,373	5,454,373
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Net Long-Term Debt

	<u><b>\$ 92,091,536</b></u>	<u><b>\$ 55,980,256</b></u>
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UTILITY BOARD OF THE CITY OF KEY WEST, FLORIDA

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006

**NOTE 6 – PRIOR YEAR DEFEASANCE OF DEBT**

During 1986, 1987, 1991, 1995, 2000 and 2001, KEYS defeased certain revenue bonds by placing proceeds of new bonds in an irrevocable trust to provide for all future debt service payments of the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in KEYS' financial statements. At September 30, 2007, \$26,107,269 of bonds outstanding relative to the 1980C, 1983, 1984 and 1980D issues, \$15,043,706 relative to the 1985 issue, \$9,888,868 relative to the 1987 issue, \$14,516,919 relative to the 1988 issue, and \$6,610,000 relative to the 1991 issue are considered defeased.

**NOTE 7 – RATE COVENANT**

KEYS has agreed to establish and revise rates such that revenues will be sufficient to pay 100% of its costs of operations and maintenance, all required reserve payments, and 125% of the principal and interest becoming due on all outstanding bonds.

**NOTE 8 – PENSION PLAN**

**Plan Description** - The Retirement System for General Employees (the Plan) is a single-employer defined benefit pension plan administered by the Board of Trustees of the Plan. The Plan provides retirement, disability and death benefits to plan members and beneficiaries. Cost of living adjustments are automatically provided to members and beneficiaries. Commencing January 1, 2001, and every year thereafter, the rate was increased from 2% to 3%. The Plan was created by resolution of the Utility Board, which the Plan by resolution assigns the authority to establish and amend its provisions to the Utility Board. The Plan issues a publicly available financial report that includes financial statements and required supplementary information for the Plan. That report may be obtained by writing to the Retirement System for General Employees, P.O. Drawer 6100, Key West, FL 33041-6100.

**Basis of Accounting** - The financial statements of the Plan are prepared using the accrual basis of accounting. KEYS' contributions are recognized when due and a formal commitment to provide the contributions has been made. Benefits are recognized when due and payable in accordance with the terms of the Plan.

Plan investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Plan investments do not include any of KEYS' debt securities. All investments represent less than 5% of Plan net assets.

**Funding Policy** – The contribution requirements of plan members and KEYS are established and may be amended by the Utility Board. Plan members have not been required to contribute to the Plan since October 1, 1985. A former member who takes a refund of accumulated contributions and who is later re-employed by KEYS within three years of his termination of service shall have the right to repay the Plan for amounts received. Upon such re-payment, the member shall receive credit for his years of credited service as of his last termination date. KEYS is required to contribute at a rate based on the annual actuarial valuation, which indicates the minimum required contribution. The minimum required contribution rate of covered payroll would be adjusted to include any benefit changes approved by the Utility Board.

**UTILITY BOARD OF THE CITY OF KEY WEST, FLORIDA**

**NOTES TO FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006**

**NOTE 8 – PENSION PLAN (Continued)**

**Pension Overpayment**- During Fiscal Year 2004, KEYS identified benefit calculation errors resulting in overpayment of benefits over several years for a group of retirees. KEYS is currently examining the effects of these miscalculations and determining a plan of action to remedy the overpayments. Effective October 1, 2004, KEYS corrected the benefit calculations to preclude subsequent overpayments.

**Schedule of Funding Progress** – KEYS’ annual contribution for the calendar year 2007 of \$2,408,066 (28.9%) was determined as part of the January 1, 2007 actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions included (a) 8.0% investment rate of return and (b) projected salary increases of 5.5% per year. Both (a) and (b) included an inflation component of 3.0%. The actuarial value of the Plan assets is the fair value of assets as reported in the Plan financial statements. The unfunded actuarial accrued liability is being amortized as a level payment on a closed basis. The remaining amortization period at January 1, 2007 was 30 years. KEYS had an unfunded actuarial accrued liability of \$8,467,396 and \$6,737,730 as of January 1, 2007 and 2006 respectively. The net pension obligation was \$(76,895) at December 31, 2006.

(1) Actuarial Valuation Date <u>January 1,</u>	(2) Entry Age Actuarial Value of <u>Assets</u>	(3) Actuarial Accrued Liability <u>(AAL)</u>	(4) Unfunded AAL <u>(UAAL)</u>	(5) Funded Ratio	(6) Covered Payroll	(7) UAAL as a Percentage of Covered Payroll
2002	\$ 49,513	\$ 50,730	\$ 1,217	97.6%	\$ 6,764	18.0%
2003	\$ 50,459	\$ 52,434	\$ 1,975	96.2%	\$ 6,845	28.9%
2004	\$ 51,439	\$ 55,408	\$ 3,969	92.8%	\$ 6,898	57.5%
2005	\$ 53,036	\$ 57,511	\$ 4,475	92.2%	\$ 6,934	64.5%
2006	\$ 54,266	\$ 61,004	\$ 6,738	89.0%	\$ 7,644	88.1%
2007	\$ 55,876	\$ 64,344	\$ 8,468	86.8%	\$ 8,344	101.5%

Calendar <u>Year</u>	Annul Pension Cost (APC)	Percentage APC Contributed	Net Pension Obligation
2001	\$ 1,245,998	100%	\$ -
2002	\$ 1,673,299	102%	\$ (26,551)
2003	\$ 1,644,221	101%	\$ (42,957)
2004	\$ 1,911,019	100%	\$ (42,578)
2005	\$ 1,979,611	102%	\$ (77,580)
2006	\$ 2,209,590	100%	\$ (76,895)

	<u>2006</u>	<u>2007</u>
Annual Required Contribution (ARC)	\$ 2,208,905	\$ 2,422,512
Interest on NPO	(6,206)	(6,152)
Adjustment to ARC	6,891	5,146
APC	<u>\$ 2,209,590</u>	<u>\$ 2,421,506</u>
Utility Board Contribution	(2,208,905)	
Increase (Decrease) in NPO	685	
NPO (beginning of year)	(77,580)	
NPO (end of year)	<u>(76,895)</u>	

Note: Fiscal Year 2006 ARC has changed to actual. The previously reported ARC was based on the actuarial's estimate.

UTILITY BOARD OF THE CITY OF KEY WEST, FLORIDA

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006

**NOTE 9 – LEASES**

Rent expense under cancelable operating leases related to copiers, mailing equipment and time clocks was \$209,554 and \$179,882 in 2007 and 2006.

**NOTE 10 – JOINT INVESTMENT**

**FKEC Transmission Agreement** – To provide the long-term transmission needs of both KEYS and the Florida Keys Electric Cooperative (FKEC), the parties entered into an agreement in which both KEYS and FKEC will maintain an appropriate ownership investment in the transmission line between the Monroe/Dade County line and the north end of the Seven Mile Bridge, at the north end of KEYS' service area. The Transmission Agreement is effective for 40 years from its effective date of January 1, 1992, or until all property, comprising the transmission line has been disposed of and all termination costs have been paid, whichever occurs last.

Based on the estimated usage of the transmission system in 1993 and 2020, and other considerations such as allocations of losses, the parties agreed that KEYS would be required to maintain 56.5% of the investment in the transmission system, and FKEC will be required to maintain 43.5% of the investment in the transmission system. Based on the agreement, KEYS is entitled, at all times, to 40% of the approximately 270 MW transfer limit of the 138 KV transmission system, which is currently estimated to be approximately 110 MW.

The foregoing allocation percentages are used: (1) to set transmission capacity entitlements, including circumstances where the capacity is fully utilized or limited (provisions have been made for either party to use the unused capacity of the other party by paying a non-firm rate based on the previous year's costs); (2) to allocate a net investment responsibility, for which capital costs are borne by each owning party, and which costs are used to calculate a fixed charge rate that is paid by either party if their net investment is less than the required investment (in addition to the fixed charge for deficit investments, the deficit party has the responsibility to make the next investment or portion thereof to establish its total net investment approximately equal to the required allocation); and (3) to determine the allocation of operation and maintenance, administration and general, renewals and replacements, upgrades, and other appropriate expenses including taxes (FKEC is responsible for the operation and maintenance of the transmission facilities within its service territory, based on recommendations from a joint operating committee, with the associated costs allocated to the parties).

Each party is responsible for losses on the transmission system based upon a loss allocation factor for each line segment, which is determined by dividing the energy flow for each party on the line segment by the total flow on the line segment. FKEC has installed substation-metering necessary to calculate the loss allocation factor, and FKEC is, therefore, responsible for performing the calculation, which is calculated on an hourly basis.

The Transmission Agreement provides for the construction of future capital additions to the transmission system, which would be paid for jointly by FKEC and KEYS based on the allocation percentages. Once parity of investment is achieved under the Transmission Agreement, any subsequent investment deficiency requires the deficient party to pay a monthly penalty to the other party, based upon a formula set out in the Transmission Agreement, which is based in part on the non-deficient party's embedded cost of debt capital.

UTILITY BOARD OF THE CITY OF KEY WEST, FLORIDA

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006

**NOTE 10 – JOINT INVESTMENT (Continued)**

Since the joint investment does not constitute a separate legal entity and no joint debt was issued to fund this project, KEYS investment in these facilities is included as part of electric plant on KEYS' balance sheet.

**NOTE 11 - PURCHASED POWER COMMITMENTS**

**All Requirements Power Supply Project** – In July 1997, KEYS agreed to become a member of the Florida Municipal Power Agency (FMPA) All-Requirements Power Supply Project (the "All-Requirements Project") and began operations as a project participant effective April 1, 1998. Under the contractual arrangement with FMPA, KEYS has assigned all of its generating and firm purchased power resources to FMPA, and FMPA will serve all of KEYS' requirements (net of up to 2 MW of non-firm capacity when available from the local resource recovery facility). Further, in the event that power cannot be delivered to the KEYS' service area over the tie line to the mainland, KEYS established a policy to have island generation capability equal to at least 60% of KEYS' peak load. KEYS and FMPA have agreed to meet these criteria through a combination of KEYS' 43.4 MW of existing generating resources and three combustion turbine units that are owned by FMPA, which currently total 79.7 MW. As part of the All-Requirements Project contract, the Florida Municipal Power Agency is required to maintain generation assets within KEYS' Service Area equal to or above 60 percent of the KEYS' load. Florida Municipal Power Agency purchased a General Electric LM 6000 (CT #4) capable of producing 43 MW which went on line in 2006, allowing KEYS to retire the Big Pine and Cudjoe High Speed Diesels (7 MW). The FMPA All-Requirements Project, the related assignment of resources by KEYS to FMPA, and other matters pertaining to KEYS' power supply are discussed in the paragraphs following.

KEYS has previously entered into several purchased power agreements with other parties including (i) the FMPA Tri-City Project, (ii) the FMPA Stanton 2 Project; and (iii) a long-term purchase agreement with FPL. As a member of the All-Requirements Project, KEYS' resources and costs under these three contracts have been assigned to FMPA.

Other power purchase and sale arrangements include KEYS' purchases from a small resource recovery unit located on Stock Island, sale of power to FKEC, and interchange service agreements with other Florida utilities and with power marketers.

KEYS appoints one representative to FMPA's Board of Directors, which governs the Agency's activities. The governance of rates charged to members includes the All-Requirements Project Committee (KEYS has one vote) and the FMPA Board of Directors (KEYS' vote is weighted based on KEYS' net energy for load).

**FMPA Tri-City Project (Stanton 1)** – KEYS is a member of the FMPA Tri-City Project (Stanton 1). KEYS and FMPA have entered into a Tri-City Project Power Sales Contract and a Tri-City Project Support Contract wherein KEYS has agreed to purchase 54.546% of FMPA's Tri-City Project. The Project consists of a 5.301% undivided ownership interest in Curtis H. Stanton Energy Center ("Stanton") unit No. 1, a 425 MW coal-fired generating unit jointly owned by the Orlando Utilities Commission ("OUC"), the Kissimmee Utility Authority, and FMPA, and operated by the OUC. Stanton Unit No. 1 began commercial operation in July 1987.

UTILITY BOARD OF THE CITY OF KEY WEST, FLORIDA

NOTES TO FINANCIAL STATEMENTS

FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006

**NOTE 11 - PURCHASED POWER COMMITMENTS (Continued)**

Based upon the unit's high dispatch rating of 425 MW, the Tri-City Project consists of a 22 MW undivided ownership and KEYS' power entitlement share is approximately 12 MW at the plant bus bar.

**FMPA Stanton 2 Project** – KEYS is a member of the FMPA Stanton 2 Project. KEYS and FMPA have entered into a Stanton 2 Project Power Sales Contract and a Project Support Contract wherein KEYS has agreed to purchase 9.8932% of FMPA's Stanton 2 Project. FMPA's Stanton 2 Project consists of a 23.2367% undivided ownership interest in Stanton Unit No. 2, a 429 MW coal-fired generating unit jointly owned by OUC and FMPA, and operated by OUC. Stanton Unit No. 2 began commercial operation in June 1996. Based on the unit's 429 MW high dispatch rating, the Stanton 2 Project consists of 100 MW undivided ownership and KEYS' power entitlement share is approximately 9.9 MW at the plant bus bar.

**Florida Power & Light (FPL) Long-Term Purchase** – KEYS entered into an agreement with FPL on August 15, 1991, entitled the Long-Term Agreement to Provide Capacity and Energy by Florida Power & Light Company to Keys Energy Services, the Utility Board of the City of Key West, Florida (the "FPL Long-Term Agreement") which became effective on June 1, 1993 after the termination of a short-term purchase agreement with FPL. The FPL Long-Term Agreement will continue in effect for 20 years. The initial purchase amount (the "Initial Contract Demand") is 45 MW. The contract demand for each year is to be designated by September 1 of each prior year, but the contract demand cannot be less than the initial contract demand during the term of the agreement. In the event KEYS' peak load during a year is lower than the KEYS peak load in the immediately preceding year, KEYS may decrease the portion of its contract demand in excess of the Initial Contract Demand, subject to certain limitations.

**NOTE 12 – COMMITMENTS AND CONTINGENCIES**

**Risk Management** - KEYS is exposed to various risks of loss related to torts, damage, theft or destruction of assets, errors or omissions, injuries to employees, and natural disasters. KEYS purchases commercial insurance policies from a commercial insurance carrier and other insurance carriers to minimize its risk of loss in these areas. KEYS' has not experienced an insurance settlement in excess of insurance coverage during the past four fiscal years. KEYS' bears the risk of loss up to the deductible amounts, which are disclosed in the accompanying statistical tables.

**NOTE 13 – NAVY CONTRACT**

The United States Navy is the largest customer of KEYS and accounted for approximately 9.4% and 9.2% of kilowatt hours sold in Fiscal Years 2007 and 2006, respectively. KEYS' contract with the Navy is for a term of ten years with a provision which requires the parties to commence negotiations for a new contract at least two years prior to the end of the current contract. The contract also contains provisions for minimum billing, service reduction and exclusive service provisions. Pursuant to this contract, KEYS has agreed to provide a maximum of 15 megawatts of power at multiple locations.

KEYS executed an amendment to the Navy's service contract on December 8, 1999, which modified the existing rate schedule. On September 12, 2007, both parties signed a new contract that shall continue in effect through August 31, 2017. All terms and conditions remain unchanged and in full force and effect.

**UTILITY BOARD OF THE CITY OF KEY WEST, FLORIDA**

**NOTES TO FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006**

**NOTE 14 – REGULATION**

According to existing laws of the State of Florida, the five members of the Utility Board act as the regulatory authority for the establishment of electric rates.

The Florida Public Service Commission (FPSC) has authority to regulate the electric "rate structures" of municipal utilities in Florida. It is believed that "rate structures" are clearly distinguishable from the total amount of revenues which a particular utility may receive from rates, and that distinction has thus far been carefully made by the FPSC. Prior to implementation of any rate change, KEYS files the proposed tariff with the Florida Public Service Commission and has established the prerequisite of a Public Notice and the holding of a Public Hearing.

The Florida Electric Power Plant Siting Act has given the FPSC exclusive authority to approve the construction of new power plants. The FPSC also exercises jurisdiction under the National Energy and the Florida Energy Efficiency and Conservation Acts as related to electric use conservation programs and prescribes conformance to the Federal Energy Regulatory Commission's Uniform System of Accounts.

Operations of KEYS are subject to environmental regulation by Federal, State and local authorities and to zoning regulations by local authorities. Federal and State standards and procedures that govern control of the environment can change. These changes can arise from continuing legislative, regulatory, and judicial action respecting the standards and procedures.

Therefore, there is no assurance that the electric plant in operation, under construction or contemplated will always remain subject to the regulations currently in effect, or will always comply with future regulations. An inability to comply with environmental standards or deadlines could result in reduced operating levels or complete shutdown of individual electric generating units not in compliance. Furthermore, compliance with environmental standards or deadlines may substantially increase capital and operating costs.

**NOTE 15 – POST EMPLOYMENT HEALTH CARE BENEFITS**

In addition to providing pension benefits, KEYS provides life insurance and health care benefits for retired employees. These benefits are provided pursuant to KEYS' personnel policies as adopted by the Utility Board. KEYS is not required to provide contributions to this benefit by any statutory, contractual or other authority.

KEYS employees hired before June 9, 1999 are eligible for these benefits if they qualify for retirement status while working for KEYS. At September 30, 2007, 120 retirees were eligible for and were receiving these benefits. These and similar benefits for active employees are provided through an insurance company whose premiums are based on the benefits paid during the year. KEYS recognizes the cost of providing these benefits on a pay-as-you-go basis by expensing the insurance premiums for retirees, which were \$985,075 and \$953,344 for 2007 and 2006, respectively.

**UTILITY BOARD OF THE CITY OF KEY WEST, FLORIDA**

**NOTES TO FINANCIAL STATEMENTS**

**FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006**

**NOTE 16 – PAYMENT TO THE CITY OF KEY WEST**

KEYS is the successor of the electric public utility once owned by the City. All electric utility property owned by the City of Key West was transferred to KEYS at the time of KEYS' creation. KEYS pays the City an annual amount as a return on the City's contribution to KEYS.

Paragraph (11) of Section 3.03 (B) of the Original Resolution 532 was amended on September 8, 1999 by Resolution 678 to be effective for the amount paid in 2001. The Board will pay to the City a sum equal to the greater of (a) \$200,000 (adjusted annually for changes in the Consumer Price index or (b) one percent (1%) of the Gross Revenues derived from sales of electricity at retail (exclusive of Power Cost Revenues which are defined as (i) revenues determined by reference to the power cost component of base rates, plus or minus (ii) power cost adjustment charges or credits.) The annual payments were \$341,279 and \$343,341 for 2007 and 2006, respectively.

**NOTE 17 – SUBSEQUENT EVENT**

In November 2007, the Utility Board transferred all funds that were held at Florida State Board of Administration Pooled Investment Fund. This was in response to a notification received from KEYS investment counselor suggesting the funds would be more accessible at a local institution. KEYS' was able to close out all accounts and secure the funds locally.

**UTILITY BOARD OF THE CITY OF KEY WEST, FLORIDA**  
**SCHEDULE OF REVENUES EARNED**  
**FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006**

	<u>2007</u>	<u>2006</u>
<b>Operating Revenues:</b>		
Electric Revenues	\$ 90,392,760	\$ 59,750,375
Power Cost Adjustment	(312,369)	34,217,993
Service Charges	248,140	134,068
Penalty Charges	601,588	470,133
Reserve Capacity	1,931,766	1,804,033
Other	168,639	94,525
Charges for New Service	<u>718,348</u>	<u>728,938</u>
<b>Total</b>	<u>93,748,872</u>	<u>97,200,065</u>
<b>Other Income:</b>		
Interest	2,032,958	1,047,716
Hurricane-Grant Revenue	550,209	3,281,600
Hurricane-Insurance Proceeds	-	273,306
CT#1 Insurance Proceeds	-	781,813
Pole Attachment	375,474	368,669
FKEC Audit Revenue	-	231,637
DOE Crude Oil Refund	-	145,416
Generating Unit Expense Reimbursement	499,609	189,742
Tree Trimming	110,550	92,565
KW Steam Plant Rental Income	179,369	173,348
Miscellaneous Non-Operating Revenue	<u>233,739</u>	<u>271,978</u>
<b>Total Other Income</b>	<u>3,981,908</u>	<u>6,857,790</u>
<b>Total Revenues</b>	<u>\$ 97,730,780</u>	<u>\$ 104,057,855</u>

**UTILITY BOARD OF THE CITY OF KEY WEST**  
**SCHEDULE OF REVENUES AND EXPENDITURES – BUDGET TO ACTUAL**  
**FOR THE YEAR ENDED SEPTEMBER 30, 2007**

	Annual Budget		Year to Date Actual	Variance- Favorable (Unfavorable)
	Original	Current		
<b>Revenues</b>				
Operating Revenues	\$ 99,235,998	\$ 99,235,998	\$ 90,080,391	\$ (9,155,607)
Other Operating Revenues	2,453,243	2,453,243	3,668,481	1,215,238
Interest Income	1,113,283	2,682,385	2,032,958	(649,427)
Hurricane - Grant Revenue	-	-	550,209	550,209
Non-Operating Revenues	<u>2,171,507</u>	<u>1,018,394</u>	<u>1,398,741</u>	<u>380,347</u>
<b>Total Budget Revenue</b>	<u>104,974,031</u>	<u>105,390,020</u>	<u>97,730,780</u>	<u>(7,659,240)</u>
<b>Expenditures</b>				
Production Expenses - Diesel	1,157,112	1,346,446	1,623,810	(277,364)
Purchased Power	63,913,044	63,913,044	58,531,619	5,381,425
Transmission Expenses	3,847,608	4,217,444	3,857,363	360,081
Distribution Expenses	4,017,991	4,071,520	3,984,022	87,498
Customer Accounts and Collection Expenses	1,306,431	1,307,438	1,332,355	(24,917)
Customer Deposit Interest	157,752	157,752	197,964	(40,212)
Administrative and General Expenses	14,756,550	12,279,831	16,306,904	(4,027,073)
Senior Lien Debt Service	8,386,900	8,386,900	8,451,537	(64,637)
Junior Lien Debt Service	976,440	976,440	948,000	28,440
Dividend to City of Key West	<u>377,762</u>	<u>377,762</u>	<u>341,279</u>	<u>36,483</u>
<b>Total Expenditures</b>	<u>98,897,590</u>	<u>97,034,577</u>	<u>95,574,853</u>	<u>1,459,724</u>
<b>Excess of Revenues Over Expenditures</b>	<u>\$ 6,076,441</u>	<u>\$ 8,355,443</u>	<u>2,155,927</u>	<u>\$ 6,199,516</u>
<b>Adjustments</b>				
Depreciation			(6,340,313)	
Principal Portion of Budgeted Debt Service			6,703,000	
Capitalized Overhead			2,103,629	
Interest Accrued but Unfunded			(1,672,883)	
Amortization of Issuance Costs			(113,096)	
Capital Contributions			225,468	
Interest on 1980C Series			(5,213)	
Amortization of Loss on Refunding			<u>(60,627)</u>	
<b>Change in Net Assets, GAAP Basis</b>			<u>\$ 2,995,892</u>	



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**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

Utility Board of the City  
of Key West, Florida  
"Keys Energy Services"  
Key West, Florida

We have audited the financial statements of the Utility Board of the City of Key West, Florida, d/b/a Keys Energy Services, ("KEYS") as of and for the year ended September 30, 2007, which comprise KEYS' basic financial statements and have issued our report thereon dated January 15, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

**Internal Control Over Financial Reporting**

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects KEYS' ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of KEYS' financial statements that is more than inconsequential will not be prevented or detected by KEYS' internal control.

Utility Board of the City  
of Key West, Florida  
"Keys Energy Services"  
Key West, Florida

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by KEYS' internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

#### Compliance and Other Matters

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

We noted certain matters that we reported to management of KEYS, in a separate letter dated January 15, 2008.

This report is intended solely for the information and use of management, the audit committee, Board of Directors, and the Florida Auditor General and is not intended to be and should not be used by anyone other than these specified parties.



OROPEZA & PARKS  
CERTIFIED PUBLIC ACCOUNTANTS

January 15, 2008