



CHAMBLISS, BAHNER & STOPHEL, P.C.

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April 12, 2007

VIA EMAIL AND USPS

Chairman Sara Kyle  
c/o Sharla Dillon  
Tennessee Regulatory Authority  
460 James Robertson Parkway  
Nashville, TN 37243-0505

Re: Docket No. 06-00290

Dear Chairman Kyle:

I have enclosed the original and six (6) copies of the City of Chattanooga's Second Supplemental Discovery Responses to Petitioner Tennessee American Water Company. A copy has also been sent via email to everyone listed on the Certificate of Service.

If there are any questions, please do not hesitate to call me.

With best regards, I am

Sincerely yours,

Frederick L. Hitchcock

FLH/sjw  
Enclosures

cc: The Honorable Sara Kyle, Chairman  
Mr. J. Richard Collier  
Mr. Jerry Kettles  
Mr. R. Dale Grimes  
Mr. J. Davidson French  
Mr. Robert E. Cooper, Jr.  
Mr. Vance L. Broemel  
Mr. Stephen R. Butler  
Mr. David C. Higney  
Mr. Henry W. Walker  
Mr. Michael A. McMahan  
Mr. Harold L. North

IN RE:	)	
	)	
PETITION OF TENNESSEE AMERICAN WATER	)	DOCKET NO.
COMPANY TO CHANGE AND INCREASE CERTAIN	)	06-00290
RATES AND CHARGES SO AS TO PERMIT IT TO	)	
EARN FAIR AND ADEQUATE RATE OF RETURN	)	
ON ITS PROPERTY USED AND USEFUL IN FURNISHING	)	
WATER SERVICE TO ITS CUSTOMERS	)	

Intervenor, The City of Chattanooga ("Chattanooga"), by and through counsel, supplements its prior discovery responses as follows, preserving all of its General Objections previously asserted and specific objections previously asserted to the question to which the response is being supplemented:

*Given that increases in the rates charged by the City of Chattanooga Electric Power Board ("EPB") for electric service are passed to TAW as a customer of that system, and those increases just be recovered in the rates of TAW as approved by the IRA, please provide:*

02423 00/0702/FLH-000162 1

**SUPPLEMENTAL RESPONSE TO REQUEST :**

Copies of the annual reports for EPB for the fiscal years ending June 30, 2001 through June 30, 2004 are being provided. The annual report for EPB for fiscal year ending June 30, 2004 is attached in electronic format and the others will be provided under separate cover.

Respectfully submitted,

CITY OF CHATTANOOGA, TENNESSEE  
RANDALL L. NELSON, CITY ATTORNEY

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### **CERTIFICATE OF SERVICE**

This is to certify that the undersigned has this day served a true and correct copy of the foregoing pleading by electronic mail and by depositing same in the United States mail, postage prepaid, and addressed to the following:

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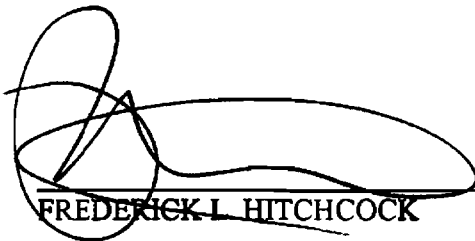
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This the 12th day of April, 2007.



FREDERICK L. HITCHCOCK

DIE-CUT

Harnessing the power of every second.

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# How much opportunity is there in a second?

How can it power and empower an entire community? How can it lead to new business divisions within our company and attract more businesses to our city? At EPB, these are the questions we challenge ourselves with every minute of every day.

After all, our mission is no less than “to enhance the quality of life in our community by providing energy, communications and related services reliably, efficiently and courteously at the lowest reasonable cost.” It’s an objective that, frankly, requires every person in our organization to continuously pursue the possibilities inherent in every moment.



A daunting task to say the least, but one that this year produced an unrelenting string of successes in all facets of our business—from making it more convenient for customers to pay their electric bill...to enabling small local businesses to tap into one of the nation’s most advanced, all-fiber, high-speed Internet connections...to creating a Business Solutions Department and empowering our Process Improvement Department to constantly search for technology solutions and ways to improve our processes...to investing in the future of our community through our support of urban renewal, schools and local charities.

Our employees can tell you from personal experience that our success requires a level of commitment that fills your heart, your mind...and most of your day. We can tell you from personal experience that it also takes a remarkably skilled, dedicated, team-oriented and diverse workforce. Which is why of all this year’s monumental achievements, reinventing our Human Resources Division stands out the most. Now we can ensure all employees will have the skills, inspiration and technology they require to grow as employees, individuals and collectively as a company.

Every second counts when you want to enhance the quality of life for every man, woman and child in the community. And, in the coming pages, we think you’ll see that everyone at EPB knows it.

Two handwritten signatures in black ink.



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# EPB: Investing in people every day

Ensuring that we will continue to meet the needs of the people outside of EPB's walls begins by ensuring we meet the professional needs of those within our walls. This year, we acted upon this people-oriented philosophy like never before by reinventing our personnel department. Now, we have a full-fledged Human Resources Division, complete with a Vice President, a staff of well-trained professionals and an unstoppable zeal for taking the initiative. As a result, its capabilities have soared from dispensing benefit forms to tackling everything from employment issues to safety procedures to job training and recruitment. And the results have been remarkable.

EPB's Board of Directors, from left: Lamar Partridge, Vice Chairman; Jon Kinsey, Member; Linda Fletcher, Member; Warren Logan, Member; Joe Ferguson, Chairman.



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### Recruiting More Efficiently

We reduced job requisition time from 63 days to 31 days, while the industry average is 60-90 days. And our pre-employment screening time has been reduced from 14 days to 5 days. This reduction alone allows us to fill positions more quickly, saving the company thousands of dollars while maintaining high levels of productivity. In the process, our mission to generate a well-rounded workforce of skilled people with varying viewpoints has yielded an ethnic and cultural diversity that goes far beyond simply mirroring the community around us. And it's making our company stronger than ever.

### Developing People

The ability to recruit top talent quickly and efficiently is just the beginning of our efforts to build a powerful people organization. We can now provide employees with a full complement of personal and professional development resources, including career mentoring, issue resolution, in-house training, improved benefits programs, professional organization support, conferences, seminars and 100% tuition reimbursement for continuing education. Everything we believe people need to reach their fullest potential.

### Rewarding People

Considering all our employees do for our company and our community, competitive starting salaries, a generous retirement plan and one of the best benefits packages in the area are only the beginning of what our workforce deserves. That's why, this year, we developed and are in the process of implementing a new compensation package that will allow us to pay employees for their performance. Performance Pay, which will be implemented later this year, is a result of an exhaustive yearlong effort that required us to evaluate performance criteria for every job function; assign a base performance value for every job; rank

all jobs and compare the jobs to national averages. But it was worth the effort because it demonstrates how much we value and appreciate the performance of each and every employee. And that helps us hire and keep good people.

### Communicating Clearly

A developing workforce means growing communication challenges. And since we place a premium on communication, we invest a lot of effort in facilitating it—from instituting skip-level management meetings, quarterly management meetings and face-to-face meetings to maintaining an open door policy and quarterly newsletters. But of all our communications channels, our newly expanded Intranet site is undoubtedly the best extension of our philosophy and who we are as a company. It's become a single source communication hub that enables employees to do everything from printing any company form or document at their desk to planning their retirement right down to the penny with our online retirement calculator.

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Company news travels faster than ever too. Last year alone, we averaged one new news story every day and 24,000 visits each month. The site also provides a forum called “Ask Harold” for employees to get direct answers from our President about important company issues or changes that may need clarification. Answers are posted on the site for everyone’s benefit. And although “Ask Harold” has proven quite popular, nothing rivals the resounding success of our Online Company Store. In its first year of operation, employees purchased more than \$25,000 of EPB apparel and related items right from their offices, a ringing endorsement of company pride.

#### **Providing Legal Support**

To better support our workforce in making business decisions, contract negotiations, and other legal matters, we’ve created an in-house Legal Department. Greater legal accessibility and a fresh insider legal perspective now allow us to routinely incorporate legal advice into the planning stages of business decisions on the front end instead of after the fact. This new capability will enable us to preempt potential issues before they arise and better manage costs if they do.

#### **Making Safety First**

To us, there is no better way to say that we care about our employees than to make every effort to ensure they leave every day in the same condition that they arrive in. As a symbol of this dedication, we created a new Safety Department that provides over 8,000 man-hours in safety training each year including eight hours of CPR and first aid training for every department. It also tracks safety data, including injury trends, which help us to prevent work-related injuries and reduce workers’ compensation costs. Of course, it’s a major investment of time, money and resources. But it’s also helped us reduce preventable injuries by 11%. What better way is there to demonstrate that employee safety is foremost in everyone’s mind?

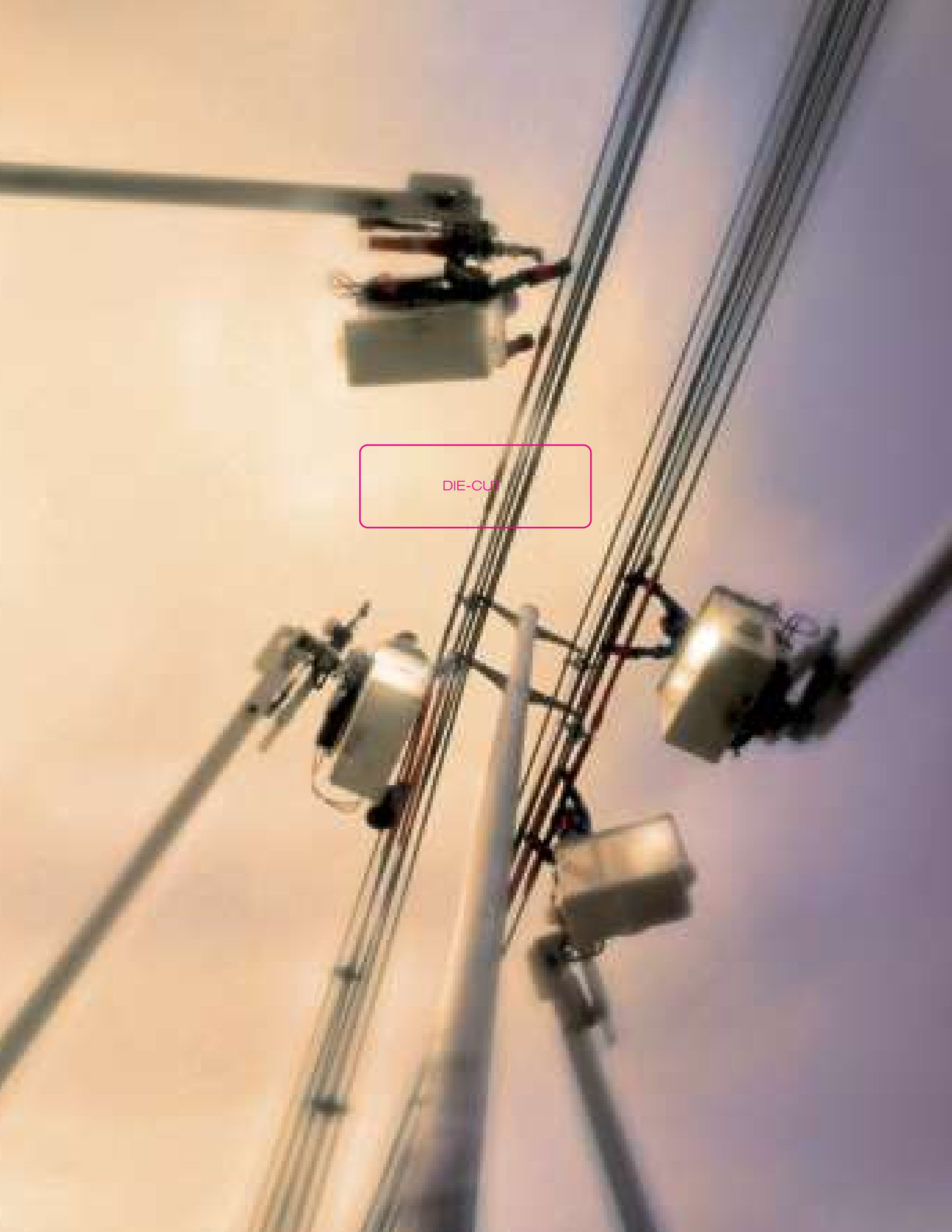
Perhaps that is why our employees care about their jobs so much: because we show them that we care about them every day. In fact, we’re very proud of our 96% retention rate over the last 12 months. To our customers and the community, it means they can continue to count on the highest level of service, reliability and efficiency in everything we do. After all, that’s what we’re all about.

This year, even though the entire electric industry saw a 3% drop in customer satisfaction overall, and despite the fact we had to pass on a rate increase from our supplier, we still achieved the second-highest customer satisfaction rating out of 78 of the nation's top utilities. Not surprisingly, affordable rates are a good part of the reason behind our success. According to a recent national utility industry survey, EPB residential customers enjoy a steady low rate of 6.7 cents per kWh while the average residential customer is paying a steadily rising rate of 8.8 cents per kWh nationwide. Maintaining such low rates when demand and cost continue to rise is why we work so hard on operating as efficiently as possible. In fact, we're one of the most efficient utilities in our region with a higher customer and revenue per employee ratio.



# Energy: 24/7

But maintaining low rates is only one part of the customer satisfaction equation. That's why we're continuously assessing and improving every aspect of our systems and operations to be more responsive, more efficient and more customer service oriented. And with over 163,000 customers in a 600-square-mile area, we know we have to continue to be vigilant if we are to keep our customers satisfied.



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### Innovating Customer Service

Many of our greatest strides in customer service this year can be attributed to innovations resulting from combined efforts of our cross-functional Customer Satisfaction Team (CST) and our Process Improvement Department, a new department within our IT Division. Focused on continually enhancing the EPB customer experience, CST's task is to evaluate every customer touch-point, recommending and implementing a wide range of policy, procedure and communication changes as needed. And as its name suggests, the Process Improvement Department's goal is to ceaselessly evaluate and innovate EPB systems and procedures to reduce redundancies, streamline processes, automate functions, improve productivity and integrate information systems. Together, they're helping reinvent customer service.

### Implementing a Work Management System

We are currently developing a Work Management System that will fully integrate many of our independent software systems. When completed, comprehensive customer information will be available company-wide at the touch of a button. For customer service representatives, it will mean immediate access to all customer records needed to resolve questions or issues on a first call basis, including specific account information,

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outage history, problem reports, even crew schedules. For field crews, it will even provide the ability to retrieve site and facility maps remotely. In short, our Work

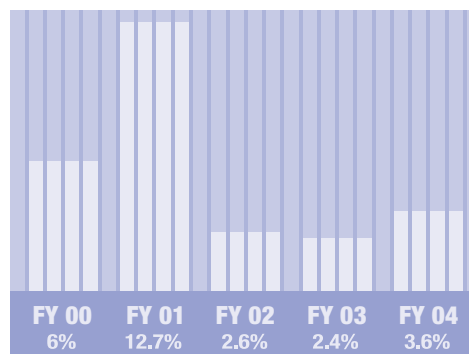
Management System will deliver total information integration, giving us the ability to meet the growing demands of our customers almost instantly.

### Creating a New Customer Issue Tracking System

We've also upgraded our customer service systems with a Customer Issue Tracking System (CITS). It tracks customer concerns, and creates a follow-up structure to help us make sure issues are resolved promptly and efficiently. In fact, most issues are handled within 24 hours; so fast, it can turn customer issues into customer satisfaction success stories. Even more importantly, CITS provides an early warning system for process, system, vendor or contractor performance problems or failures, allowing us to correct potential problems before they get out of hand. In all, it's a great tool for maintaining our high level of customer satisfaction.

### Introducing High-End and Automatic Metering

We've expanded high-end metering capabilities to enable our larger industrial customers to monitor and manage their day-to-day energy consumption with real-time data over fiber-optic cables. Now, many industrial customers are able to



Customer Service Call Abandonment Rates



adjust energy usage on the fly to better manage costs before they receive their bills. And for those customers whose meters are inaccessible, we now have automatic meter reading with nearly 500 radio-read meters currently deployed. Where feasible, these systems eliminate the need to estimate consumption and deliver more reliable, accurate meter readings.

### **Upgrading Customer Service Billing Systems**

Putting enough information at our Customer Service Representatives' fingers to resolve just about any customer concern almost instantaneously—that's the ultimate goal of our current \$1 million-plus billing system upgrades which we began installing last year and completed in July. All without interfering with our level of customer service. In fact, we reduced the average walk-in customer's wait time from 5 minutes to 1 minute and increased the number of calls our Customer Service Representatives handle by 3%.



### **Moving to Mobile Data**

With customers spread out over a 600-square-mile area, the need for mobile data to assist field crews and metering teams is immense. That's why we've begun installing Global Positioning Systems (GPS) and GT Viewers in our metering and service trucks. Our goal is to have instant real-time access to such critical information as exact individual customer, facility and equipment locations as well as specifications for all of our crews. Dispatching will also have the real-time information it needs to match and deploy the best qualified crews to get the job done—efficiencies that not only save our customers money but can make all the difference in an emergency.



### **Listening to Our Customers**

Sometimes improvements in customer service come from a more low-tech source: listening. This year we listened extensively to our customers through several qualitative and quantitative research projects in order to better





identify their needs. As a result of this research, we redesigned our billing statements to make them easier to read and, more importantly, to provide the most appropriate level of information relative to specific needs of our various customer types: residential, industrial and commercial. Large industrial customers understandably want more detailed reporting on their billing statements than residential customers. In addition to making bills easier to read, we made them easier to pay. Now, customers may pay bills by phone or over the Internet with a credit card or electronic check—24 hours a day. It's called Speedpay,<sup>®</sup> and it's already receiving a tremendous response. As of June 30, 2004, there were 42,911 payments, just over \$5.2 million. The average payment was \$122.26, with 60% paying by credit card and 40% by electronic check. The system also notifies EPB of payments immediately, so any adverse credit action can be avoided or remedied. In fact, enhanced payment options and improved collections efforts this year enabled us to achieve our lowest bad debt in 27 years of just \$217,416 (excluding bankruptcy)—an 11% improvement over last year and 54% of our goal.

### Ensuring Dependability

When you respect and appreciate someone, keeping a promise to them comes naturally. So when we make a time commitment for new installations or service to existing lines, we meet those commitments nearly 100% of the time. And if for some reason we can't make it, we call to reschedule 100% of the time. In other companies, this is the result of a strict corporate

mandate. To us, it's simple common courtesy. More impressively, in the last year alone our employees innovated ways to improve our turnaround for underground service installation from 4-6 weeks to just 8 days. In fact, overall productivity for our Construction Department improved 11.4% over the last fiscal year with the same number of employees.

### Focusing on Reliability

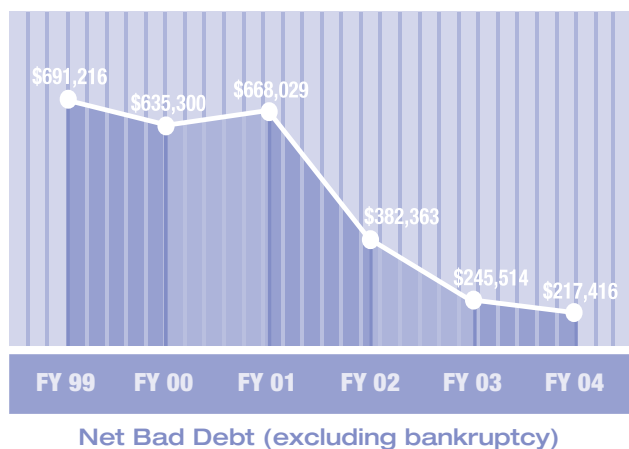
Even before affordability, our customers expect reliability. This year we established a team whose sole purpose is to ensure it: The Reliability Team. Its first efforts

focused on identifying priorities for improving reliability. As it turns out, they discovered trees are the number one cause of outages. Their solution, which includes the creation of a new department of Vegetation and Environmental Control, is the most aggressive

and comprehensive tree-trimming program in EPB's history. And it is expected to have an almost immediate impact on reliability and customer satisfaction. The team is also reviewing customers with three or more outages in a given year. The goal is to identify the cause, or causes, and correct issues within our control. While we know we can't prevent all outages, we expect to limit these to such a degree that we maintain one of the best reliability ratings in the nation.

### Tailoring Service to Key Customers

No two commercial or industrial customers experience a power outage in the same way. For some, a momentary power loss during a storm is no more than the inconvenience a residential customer may feel. But other customers with highly sophisticated machinery can incur significant and costly damage resulting from downed equipment. That's why, as part of our Key Customer program, we are examining the effects of momentary and duration outages among our key industrial customers. Our goal is to create storm-outage response protocols for crew dispatching that enable us to reestablish power to the most vulnerable customer systems first, minimizing and/or preventing potential damage to their systems or equipment. We're also providing key customers with a single contact to ensure their individual needs are met 100% of the time, especially during an outage.





### **Energizing Energy Right**

Building Energy Right homes is the right thing to do for our customers, our community and the environment. So when budget cutbacks forced TVA to dramatically reduce its funding for the program, EPB committed to fully funding Energy Right on its own. We even brought in Doug Rye, a Residential Energy Consultant, to personally educate builders on how to make the homes they build more energy efficient. Doug is one of the best-known energy consultants in the nation. The homes built using his techniques utilize innovative insulation, joints and windows and are guaranteed not to exceed a specific amount in heating and cooling costs.

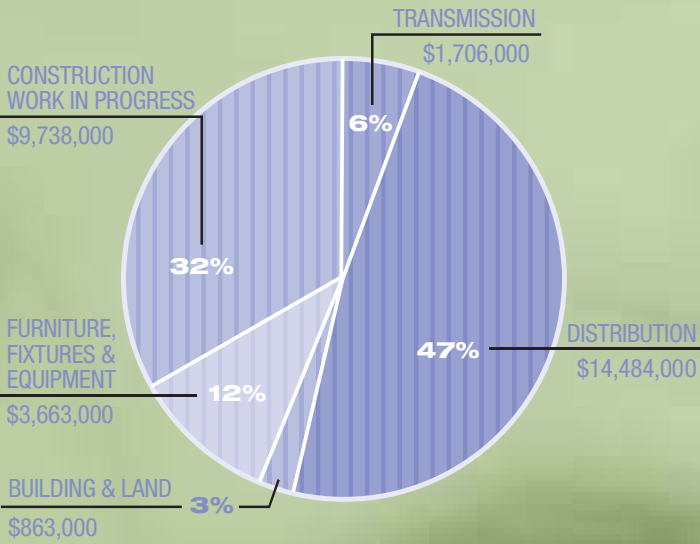
### **Marketing the Fuel of Choice**

With gas prices soaring 136%, we seized on an opportunity to educate consumers with an aggressive electric power ad campaign, achieving remarkable results.

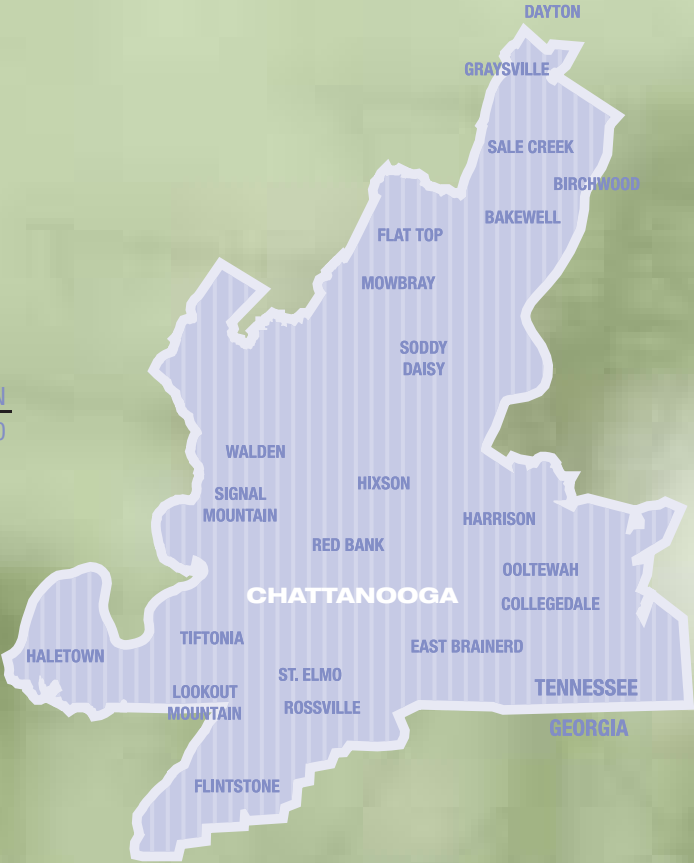
5.7% more energy users now believe electricity is more cost effective than gas. And for the first time, 4% more users would prefer an electric heat pump over a gas furnace, decreasing customers' preference for a natural gas furnace by 5.3%.

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EPB Electric Power  
Capital Improvements



EPB Electric Power  
Service Area



# EPB Electric Power at a glance

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## ELECTRIC DELIVERY STATISTICS

### TRANSMISSION LINE MILEAGE

161 kv	2 miles
46 kv	322 miles
<b>Total</b>	<b>324 miles</b>

### DISTRIBUTION LINE MILEAGE

Overhead primary	2,896 miles
Underground primary	489 miles
<b>Total</b>	<b>3,385 miles</b>

### SUBSTATIONS

Distribution substations	114
Transmission substations	10
<b>Total</b>	<b>124</b>

### TRANSFORMERS

Overhead transformers	52,335
Pad-mount transformers	7,386
Other transformers	421
<b>Total</b>	<b>60,142</b>

### POLES

EPB energy poles	90,049
<b>Total</b>	<b>90,049</b>

## PROGRAMS & SERVICES

### COMMERCIAL

Power Quality Survey  
Power Factor Correction  
Harmonic Analysis  
Energy Audits  
Lighting Recommendations  
Compressed Air Leak Detection  
HVAC Studies  
Industrial/Commercial Services  
Enhanced Growth Credit  
Green Power Switch®  
Rate Analysis  
EZ Pay  
Power Quality Analysis  
Infrared Scanning for Power Quality  
Energy Monitoring and Management

### RESIDENTIAL

Budget Billing  
EZ Pay  
Green Power Switch®  
Third Party Notification  
Life Support  
Power Share<sup>SM</sup>  
Speedpay®  
Language Interpreters  
Lighting  
TTD/TTY Services

# Communications: up-to-the-minute solutions

The past year saw a reaffirmation of our Telecom Division's focus to go beyond products and services to deliver what business customers truly need—solutions. In doing so, we enjoyed a year of growth and success. One of the most dramatic indicators of this success was a trend toward a greater number of large companies in our customer mix. In fact, this past year alone, two of the largest users of telecom services in the area signed with EPB Telecom. In addition, fueled by the marketing efforts and media interest surrounding our new All-Fiber Internet Solution,<sup>SM</sup> we saw our brand awareness grow by 6%—the largest increase of any telecom provider in the market.

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### Launching the Internet Service Businesses Have Been Dreaming About

Surpassing first-year new customer forecasts by 79% is a good indication that our Business Internet Service exceeded all market expectations. And no doubt that was our goal. We set out to bring affordable access to any size bandwidth for any size business. And we delivered. Our customers can choose from traditional Internet connections of up to 1.5 MB of



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bandwidth to our All-Fiber Internet Solution<sup>SM</sup> with up to 500 MB of bandwidth—a capacity up to 300 times faster than a standard DSL, cable or T-1 connection. That's far more than any business could conceivably need today, and one that's usually exclusive to larger U.S. markets such as New York, Chicago and L.A. And whether a customer chooses an all-fiber or traditional solution, all our bandwidths come with a wide range of services, including email addresses, web hosting with Unix server, domain name, web storage space, monthly data transfer, static IP addresses and routers. EPB Telecom Business Internet—it's what businesses have been dreaming about and more.

### Building a More Efficient Fiber-Optic Network

Over the course of the past year, we've worked hard to expand and improve our already extensive fiber-optic network, deploying nearly 16 additional miles of fiber for a total of 70 fiber miles. Our customers also benefited through increased capacity of services on the network as well as the availability of fiber-optic products in new areas. And we benefited through reduced cost and less reliance on ILEC facilities.



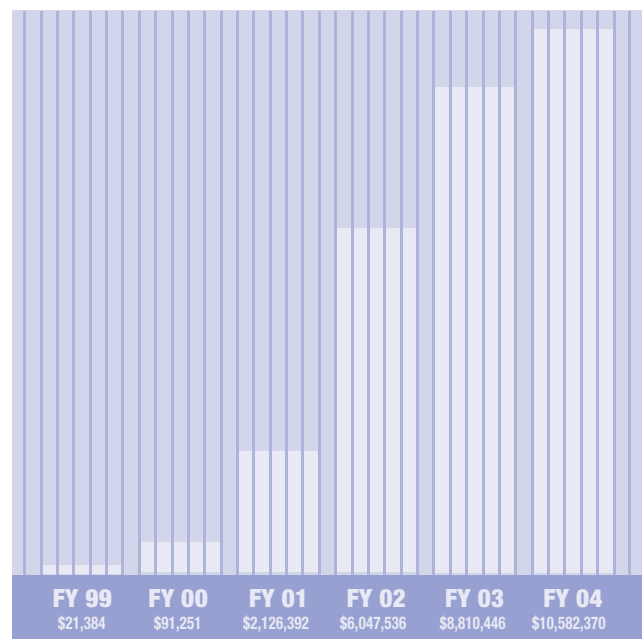


### Attracting Customers with New “Fiber-to-Business” Technology

Our customers appreciate that we offer them the latest technology. But, even more important, we back it up with reliable service and rapid response times. To better serve our customers, we launched “fiber-to-business” technology utilizing Wave7 Optics technology. This new equipment allows EPB Telecom to reach any business, large or small, with telephony, data and video services.

### Attracting and Serving Larger Accounts

Much like a growing community benefits everyone, our recent addition of a number of large accounts offers added stability to our growing telecommunications business. These larger accounts are generally more loyal and more likely to provide a greater return on our investment. All of this has a positive effect on our ability to service all customers—large and small. Whether servicing a customer with 5 lines or 1000+ lines, we’re committed to delivering innovative solutions and proven reliability.



Telecom Division Operating Revenue



# Community: taking time to help

While EPB's products generally fall into the categories of electric power and communications, our mission—and our passion—is community service. We understand that our shareholders are every man, woman and child in the community we serve and we're here to help them. This year, people from every department volunteered thousands of hours of community service, helping a wide variety of charitable organizations in the process. As a company, in 2004 EPB funded \$200,000 toward a five year plan (a total of \$1,000,000) for Chattanooga's 21<sup>st</sup> Century Waterfront Development. And we're continuing to annually honor our commitment of \$125,000 a year for four years (a total of \$500,000) to the Chattanooga Area Chamber of Commerce in support of efforts to attract new businesses to our hometown. It's all part of striving to build a better community for our customers, and our employees. After all, we live here, too.

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A low-angle, upward-looking photograph of a young boy with blonde hair, smiling and climbing a dark metal rope structure. The boy is wearing a light-colored t-shirt and dark shorts. The background is a bright, clear blue sky. A bright sun flare is visible in the upper left corner. A white rectangular label with rounded corners and a thin black border is positioned in the center of the image.

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### Taking a Leadership Role in Helping Our Community

Each year our employees volunteer to help the community where help is needed most. This year, everyone from VP's to Linemen to Customer

Service Representatives volunteered more than 4,000 hours of community service and helped 157 charitable organizations, including the United Way, Girls Inc., Blood Assurance, the Urban League and our partners in education—Battle Academy, Orchard Knob Middle School and Brainerd High School. In addition, nearly two-thirds of EPB's Vice Presidents and Managers currently serve on civic or charity boards or work with such organizations. In all, it's the kind of community leadership that we're proud to say makes a difference and, this year, was publicly recognized by a number of organizations.

Girls Inc. named EPB their "Strong, Smart and Bold Corporation of the Year."

The Urban League named EPB "Corporation of the Year."

The NAACP named EPB "Business of the Year."

Junior Achievement awarded EPB their "Cum Laude" award.

The Public Relations Society of America awarded EPB their "Incline Award" for our Power Share program.

### Encouraging Economic Development

A community is only as strong as its economy. So if there's something we can do to help attract more business to Chattanooga and to help existing businesses prosper, we'll do it. That's why we created a new Economic Development Department. Its job is to

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help provide key customers with the resources, expertise and assistance needed to maintain and grow their businesses, all the while helping local, state and federal economic development

agencies market Chattanooga to the world. It's also why we provide critical support for new companies, including women- and minority-owned businesses. Support that includes making sure every qualified business has an equal opportunity to bid on the goods and services EPB purchases. The result? Nearly 20% of our total outside expenditures went to women- and minority-owned businesses this year. That represents a total of \$1,968,941 in funds (227% of last year's total) that were not set aside but competitively won. And our support goes even further. This year we also helped a start-up minority-owned company actually develop a meter-reading service to fulfill our growing reading needs instead of contracting with an out-of-town service. After all, every successful local company contributes to a stronger economy for all of us.

### Giving our Customers a Green Power Choice

At first glance, helping the environment and delivering reliable, efficient energy to our community might seem unrelated. But with today's Green Power, these two goals are rapidly converging. Green Power is electricity generated by renewable resources such as wind, sun, and methane gas. TVA, EPB and other power distributors, working in cooperation with the environmental community, developed Green Power Switch® as a way to bring electricity generated by cleaner renewable resources to area consumers.

EPB is encouraging both its residential and business customers to join TVA-partnered Green Power Switch and help create a cleaner environment for our community. This year, more customers than ever have made the switch to Green Power. It's a choice that will benefit all of us for years to come.

### **Conducting Fire Fighter Safety Awareness**

At EPB, safety is a major concern, not only for our employees, but for the people we serve, as well. So to

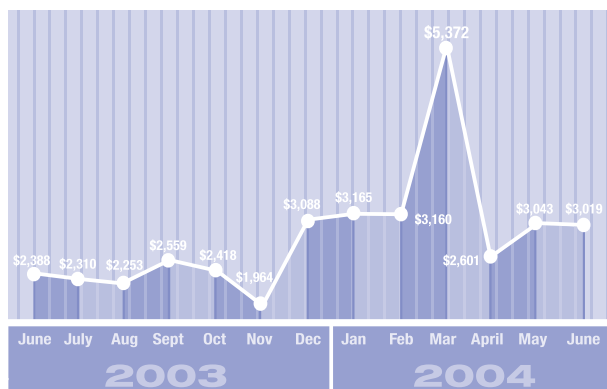
further enhance safety awareness in our community, we developed, facilitated and conducted a 15-week electrical safety presentation for the Chattanooga Fire Department. Approximately 300 local fire fighters were trained regarding the potential hazards associated with high voltage equipment and how to avoid injury. This training will also aid EPB with safe service restoration during emergencies such as storms, structural fires and vehicle accidents that involve our facilities.





### Helping Neighbors Help Neighbors

Sometimes, even the most responsible people have difficulty paying their utility bills—often for reasons that are beyond their control. To help, we improved upon an existing program that collects donations from customers to provide utility assistance to those in need. The resulting “Power Share<sup>SM</sup>” program has been a tremendous success, with donations increasing by 23% over last year—proof once again that, given the opportunity, many of our customers are just as eager to help their neighbors as we are.



Power Share<sup>SM</sup> Contributions

### Empowering Future Generations

Of all of EPB's community service efforts, our involvement in education is perhaps the most rewarding.

Nothing is more important to us than the future of our children, and this year, as in years past, we worked hard to help them in a number of different ways. For example, by partnering with local

DIE-CUT





schools we're helping ensure a quality education for local school kids by providing books, videos, computers, printers and after school tutoring for hundreds of students. We also continued spreading the word about electric power safety among elementary and middle school students with our popular Dr. Shock programs.

This year alone, Dr. Shock visited an average of four schools a month, reaching 3,500 kids through live presentations and even more via our website. And, in what's become a tradition, we once again printed tens of thousands of report card covers for public school students.

EPB's Senior Management Team, from left: Harold DePriest, President & CEO; Carlos Smith, General Counsel; Steve Clark, Vice President, Reliability & Maintenance; Kathy Harriman, Vice President, Telecom; Aldous McCrory, Vice President, Legal Services; Preston Suggs, Vice President, Finance & CFO; Sandy Buquo, Vice President, Marketing & Communications; Ron Fugatt, Executive Vice President; David Wade, Vice President, Engineering & Construction; Marybeth Williams, Vice President, Customer Relations; Tony Powell, Vice President, Human Resources; David Thomas, Vice President, Information Technology & CIO.

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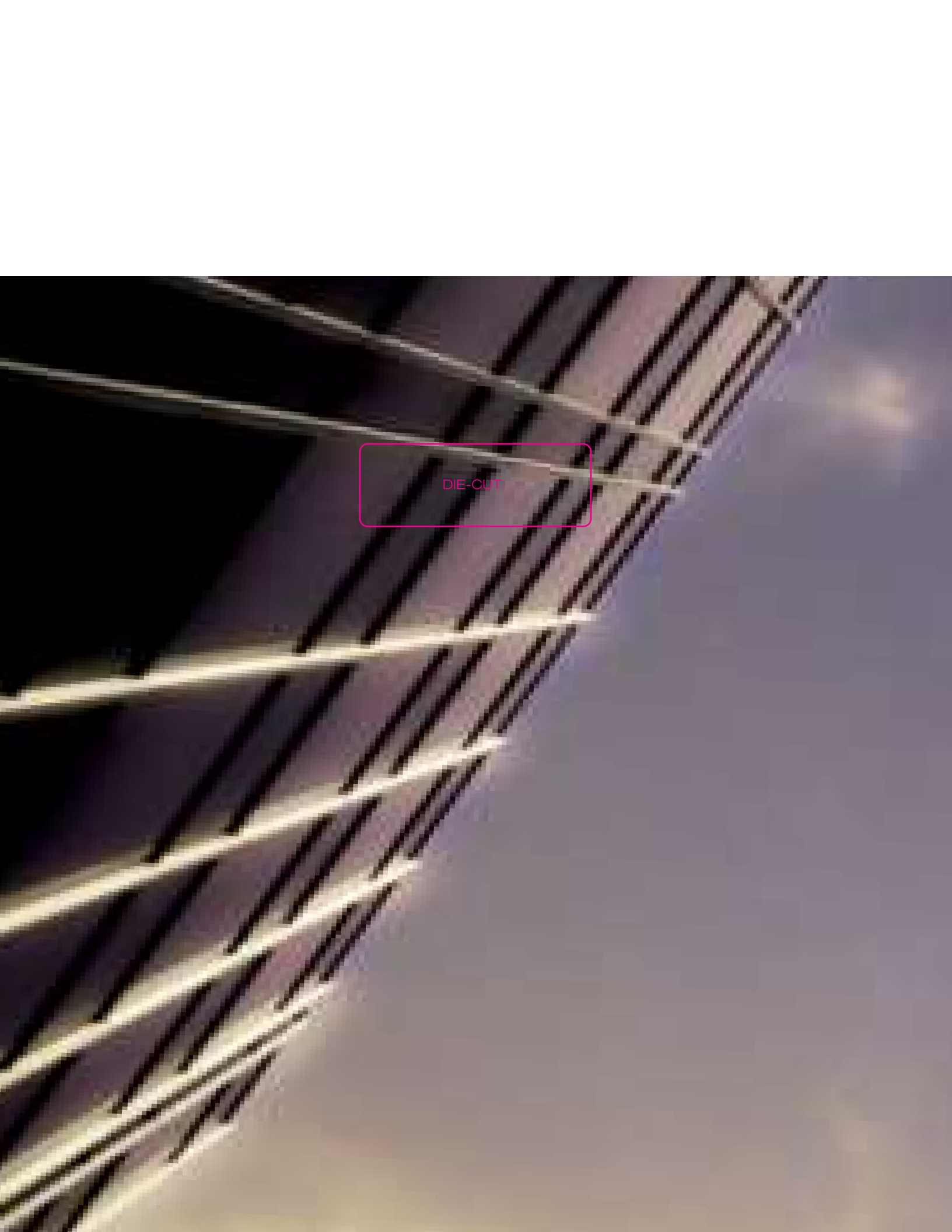
# How much opportunity is there in a second?

Unlimited. At least that's how EPB employees seem to see it. And the sheer volume of our accomplishments in electric power, communications and community service this year certainly bear that out. It's an attitude of achievement that pervades every task we undertake. Fittingly, it's especially evident in the effort behind the creation of our new headquarters. The \$30 million project, scheduled for completion late summer 2005, is designed to aesthetically complement Chattanooga's historic architecture while at the same time be one of the most energy efficient and sustainable buildings in the country. Recycled materials incorporated throughout the building's construction include everything from carpet, carpet-backing, linoleum and steel products. Likewise, the building features a wide range of high-efficiency and solar lighting fixtures, including the use of an innovative six-story atrium that will allow natural daylight to brighten much of the building's interior. What's more, lighting, security, heating and air conditioning will be managed by a single Integrated Facility Management System for maximum efficiency. It's no wonder the American Council of Engineering Companies recently recognized it as a model of modern sustainability with an award for engineering excellence.



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DIE-CUT

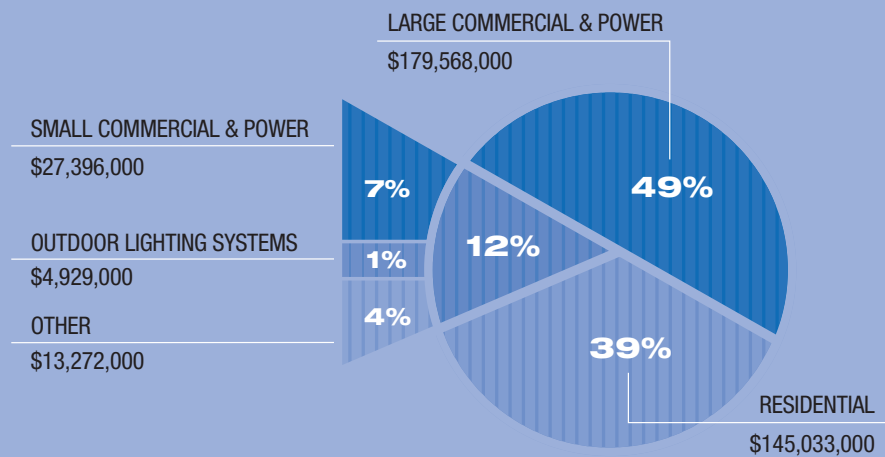
# 2004 Financials

LENTICULAR CLOCK ART

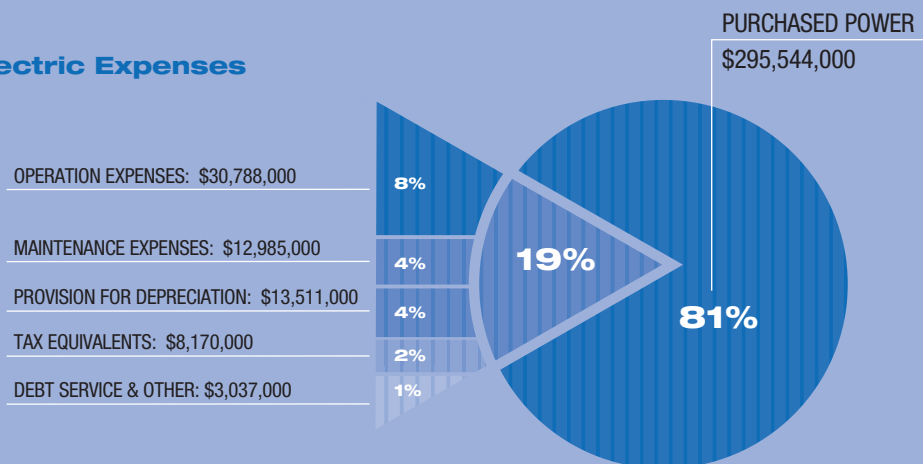


EPB provided electric service to 163,356 customers in a 600-square mile area—a growth of 2,656 customers from FY 2003—resulting in electric sales revenue of \$361 million. Residential customers paid an average of 6.67 cents per kWh—24% less than the national average. Net electric plant value totaled \$240 million.

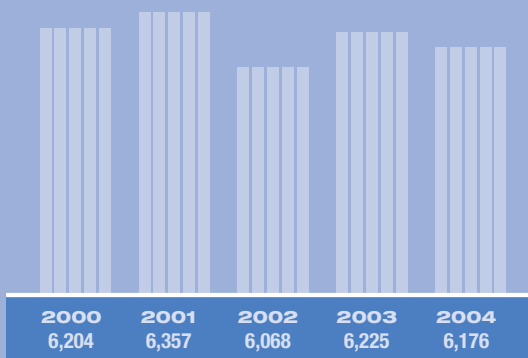
### Electric Revenues



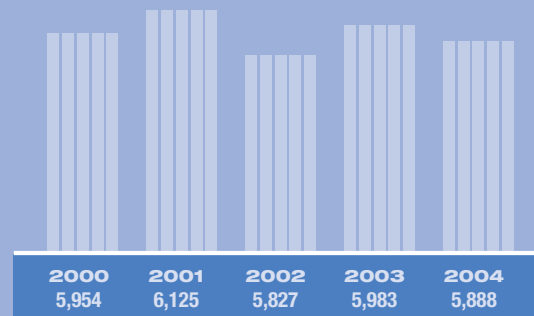
### Electric Expenses



### Average Cost Per kWh PER RESIDENTIAL CUSTOMER (CENTS)



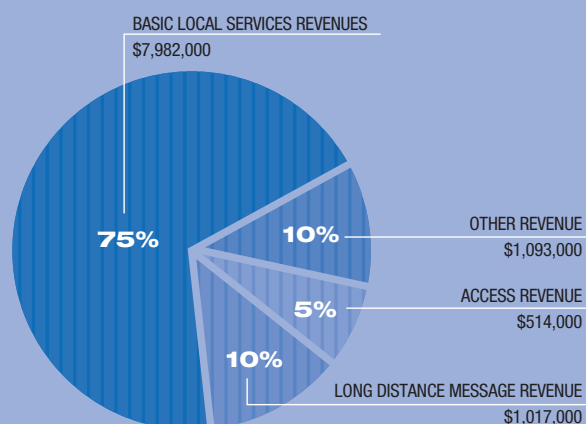
**Kilowatt Hours Purchased**  
(MILLIONS)



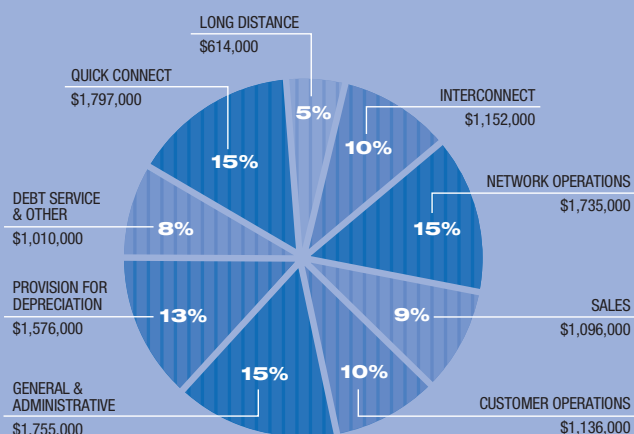
**Kilowatt Hours Billed**  
(MILLIONS)

EPB Telecommunications System has grown from 13,487 lines in FY 2003 to 14,529 lines in FY 2004. Telecommunications' revenues increased from \$8.8 million in FY 2003 to \$10.6 million in FY 2004. In addition to the acquisition of new customers, telecommunications' growth is also due in large part to the continued expansion of existing clients who have added an average of 1-2 lines, including data services and other service additions to their telecommunications networks. The net plant value of \$12 million includes a seventy mile fiber network for the Greater Chattanooga area. The telecommunications system had 35 employees at year-end.

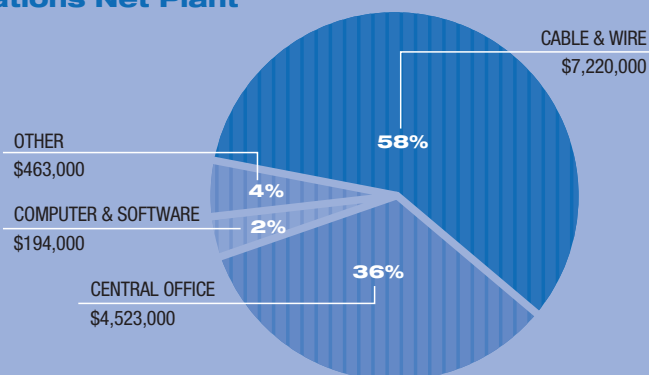
### Telecommunications Revenues



### Telecommunications Expenses

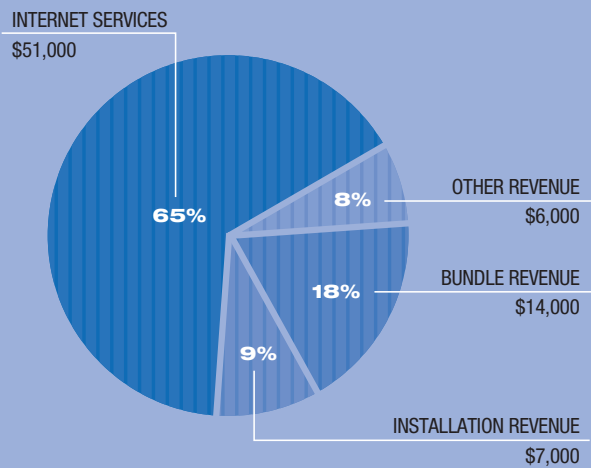


### Telecommunications Net Plant

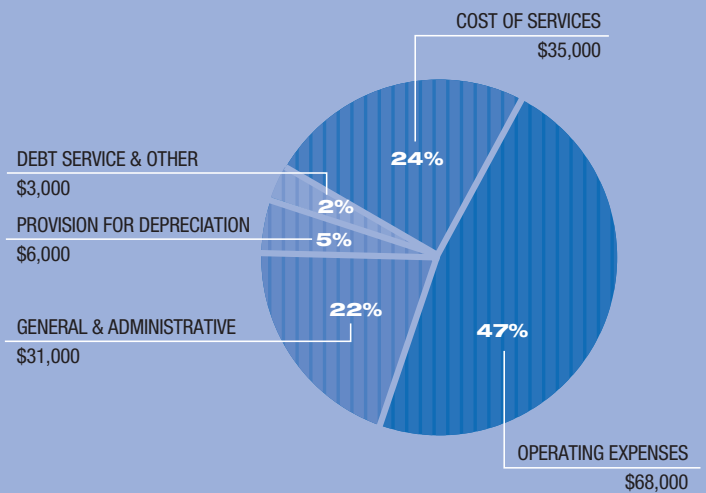


EPB Internet System provided service to its first customer in November 2003 and, by the end of FY 2004, was providing service to 139 customers—resulting in revenues of \$78,000 for FY 2004. Net internet plant value was \$56,000.

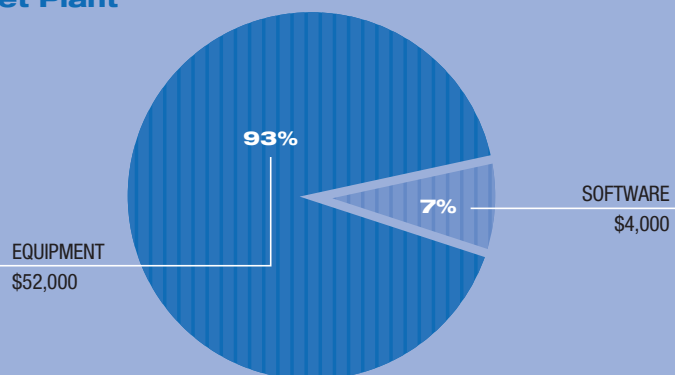
### Internet Revenues



### Internet Expenses



### Internet Net Plant



This Management's Discussion and Analysis is in accordance with Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, which EPB implemented in the fiscal year ended June 30, 2002. Our discussion and analysis of EPB's financial performance provides an overview of financial activities for the fiscal year ended June 30, 2004. Please read it in conjunction with EPB's financial statements, which follow this section.

## FINANCIAL HIGHLIGHTS

- EPB's total net assets increased \$4.8 million, or 2.1%.
- During the year electric sales increased \$11.7 million or 3.3%; telecommunications revenues increased \$1.8 million, or 20.1%.
- Total operating expenses increased \$9.7 million or 2.7%.

## OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report includes this Management's Discussion and Analysis report, the independent auditor's report and the basic financial statements of EPB. The financial statements also include notes that explain in more detail some of the information in the financial statements.

## REQUIRED FINANCIAL STATEMENTS

The financial statements of EPB report information using accounting methods similar to those used by private sector companies. These statements offer short- and long-term financial information about its activities. The Balance Sheet includes all of EPB's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to EPB creditors (liabilities). It also provides the basis for evaluation of the capital structure of EPB and assessing the liquidity and financial flexibility of EPB.

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 measures the success of EPB's operations over the past year and can be used to determine whether EPB has successfully recovered all its costs through rates and other charges, profitability, and credit worthiness.

The final required financial statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operating, investing, and financing activities and provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

## FINANCIAL ANALYSIS OF EPB

One of the most important questions asked about EPB's finances is "Is EPB as a whole better off or worse off as a result of this year's activities?" The Statement of Net Assets, and the Statement of Revenues, Expenses and Changes in Net Assets report information about EPB's activities in a way that will help answer this question. These two statements report the net assets of EPB and the changes in them. One can think of EPB's net assets—the difference between assets and liabilities—as one way to measure financial health or financial position. Over time, increases or decreases in EPB's net assets are an indicator of whether its financial health is improving or deteriorating. However, one will need to consider other non-financial factors such as weather, economic conditions, population growth, and new or changed governmental legislation.

## NET ASSETS

Our analysis begins with a summary of EPB's Balance Sheets in Table 1.

**Table 1**  
**Condensed Statements of Net Assets (Balance Sheets)**  
(IN THOUSANDS OF DOLLARS)

	FY 2004	FY 2003	DOLLAR CHANGE	TOTAL PERCENT CHANGE
Current and Other Assets	\$ 121,450	\$ 119,356	\$ 2,094	1.8
Utility Plant, Net	252,868	237,720	15,148	6.4
Total Assets	374,318	357,076	17,242	4.8
Long-term Debt Outstanding	33,539	35,136	(1,597)	(4.5)
Other Liabilities	105,758	91,752	14,006	15.3
Total Liabilities	139,297	126,888	12,409	9.8
Invested in Utility Plant, Net of Related Debt	218,100	201,369	16,731	8.3
Unrestricted	16,921	28,819	(11,898)	(41.3)
Total Net Assets	\$ 235,021	\$ 230,188	\$ 4,833	2.1

As can be seen from the table above, net assets increased \$4.8 million to \$235.0 million in FY 2004 up from \$230.2 million in FY 2003. This increase reflects capital assets financed primarily from EPB's net assets/equity, and reflects favorable results of operations.



Invested in Utility Plant, Net of Related Debt increased \$16.7 million. In FY 2004, EPB invested an additional \$27.1 million in utility plant, and had a \$12.0 million increase in the accumulated provision for depreciation, for an increase in net Utility Plant of \$15.1 million. Adding to this net increase was a decrease in Long-Term Debt of \$1.6 million. This was a result of EPB paying a \$1.6 million bond principal payment.

**Table 2**  
**Condensed Statements of Revenues, Expenses,**  
**and Changes in Net Assets (IN THOUSANDS OF DOLLARS)**

	FY 2004	FY 2003	DOLLAR CHANGE	TOTAL PERCENT CHANGE
<b>OPERATING REVENUES:</b>				
Electric Sales	\$ 360,507	\$ 348,824	\$ 11,683	3.3
Telecommunications Revenues	10,582	8,811	1,771	20.1
Internet Revenues	78	—	78	100.0
Other Operating Revenues	6,074	5,930	144	2.4
Total	377,241	363,565	13,676	3.8
<b>OPERATING EXPENSES:</b>				
Electric	339,141	330,523	8,618	2.6
Telecommunications	8,807	7,992	815	10.2
Internet	134	37	97	262.2
Provision for Depreciation	15,093	14,630	463	3.2
Tax Equivalents	8,648	8,935	(287)	(3.2)
Total	371,823	362,117	9,706	2.7
<b>OTHER REVENUES (DEDUCTIONS)</b>	(1,919)	(1,569)	(350)	22.3
<b>INCOME (LOSS) BEFORE CONTRIBUTIONS</b>	3,499	(121)	3,620	2991.7
<b>CONTRIBUTIONS</b>	1,334	1,058	276	26.1
<b>CHANGE IN NET ASSETS</b>	<b>4,833</b>	<b>937</b>	<b>3,896</b>	<b>415.8</b>
<b>BEGINNING NET ASSETS</b>	230,188	229,251	937	0.4
<b>ENDING NET ASSETS</b>	\$ 235,021	\$ 230,188	\$ 4,833	2.1

While the Balance Sheets show the change in financial position of net assets, the Statements of Revenues, Expenses and Changes in Net Assets provide answers as to the nature and source of these changes. As shown in Table 2 above, income before contributions of \$3.5 million and contributions in aid of construction of \$1.3 million were the two sources of the increase in net assets of \$4.8 million in FY 2004.

A closer examination of the sources of changes in net assets reveals electric revenues increased by \$11.7 million to \$360.5 million in FY 2004 from \$348.8 million in FY 2003. This increase is due mainly to the Tennessee Valley Authority (TVA) rate increase effective October 1, 2003.

Weather has the greatest impact on residential electric sales and weather is reflected in degree-days, as recorded by the National Weather Bureau. Degree-days measure the average daily temperature in relationship to 65 degrees: temperatures above 65 degrees are cooling degree-days; temperatures below 65 degrees are heating degree-days. In FY 2004, there were 4,947 total degree-days, a decrease of 3.3% from the 5,115 degree-days in FY 2003. This decrease however was more than offset by the TVA rate increase effective October 1, 2003 resulting in an increase of \$2.7 million in residential electric sales in FY 2004 compared to FY 2003.

Commercial and industrial electric sales for FY 2004 were \$4.8 million more than in FY 2003. This increase is also mainly due to the TVA rate increase.

Electric operating expenses increased by \$8.6 million to \$339.1 million in FY 2004, up from \$330.5 million in FY 2003. The amount of power purchased from TVA increased \$10.8 million in FY 2004 compared to FY 2003 due to the TVA rate increase of October 1, 2003. Other operating expenses were lower in FY 2004 because EPB did not experience the \$2.7 million cost of two major storms it had in FY 2003.

Telecommunications operating revenue increased by \$1.8 million to \$10.6 million in FY 2004 from \$8.8 million in FY 2003, primarily the result of increasing the number of lines during the year. Operating expenses associated with acquiring and serving customers increased \$0.8 million to \$8.8 million in FY 2004 from \$8.0 million in FY 2003.

Internet operating revenues increased from \$5,000 in November 2003 (the first month of operations) to \$21,000 in June 2004, totaling \$78,000 for FY 2004. Operating expenses associated with providing service to EPB Internet customers were \$134,000 for FY 2004.

Provision for depreciation expenses increased by \$0.5 million to \$15.1 million in FY 2004 from \$14.6 million in FY 2003, an increase of 3.2%. This increase is the result of growth in utility plant, for the electric, telecommunications, and internet systems .

Accruals for payments in lieu of taxes (tax equivalents expense) to municipal governments decreased by \$0.28 million to \$8.65 million in FY 2004 from \$8.93 million in FY 2003, a decrease of 3.2%. \$8.57 million was accrued for Tennessee tax districts in FY 2004, with the remainder being accrued for Georgia tax districts. EPB's Tennessee tax equivalents expense is based on a prescribed formula that consists of two parts. Part I is calculated using utility plant value within a taxing district, the taxing district's property tax rate, the assessment ratio, and the equalization ratio. Part II is based on the average of the last three years' Tennessee operating revenues less cost of goods sold, and a prescribed rate which is currently 4%. The tax equivalents expense decrease in FY 2004 was primarily due to a drop in Hamilton County's equalization ratio set by the State of Tennessee.

## BUDGETARY HIGHLIGHTS

EPB's Board of Directors approves an Operating and Capital Budget each fiscal year. The budget remains in effect the entire year and is not revised. A FY 2004 budget comparison and analysis is presented to the Board as interim financial statements; however, they are not reported on nor shown in the financial section of this report.

A FY 2004 budget comparison and analysis is presented in Table 3.

**Table 3**  
**Actual vs. Budget** (IN THOUSANDS OF DOLLARS)

	ACTUAL FY 2004	BUDGET FY 2004	DOLLAR CHANGE	TOTAL PERCENT CHANGE
<b>OPERATING REVENUES:</b>				
Electric Sales	\$ 360,507	\$ 346,859	\$ 13,648	3.9
Telecommunications Revenues	10,582	11,061	(479)	(4.3)
Internet Revenues	78	66	12	18.2
Other Operating Revenues	6,074	5,948	126	2.1
Total	377,241	363,934	13,307	3.7
<b>OPERATING EXPENSES:</b>				
Electric	339,141	326,769	12,372	3.8
Telecommunications	8,807	9,382	(575)	(6.1)
Internet	134	79	55	69.6
Provision for Depreciation	15,093	15,159	(66)	(0.4)
Tax Equivalents	8,648	9,186	(538)	(5.9)
Total	371,823	360,575	11,248	3.1
<b>OTHER REVENUES (DEDUCTIONS)</b>	(1,919)	(1,993)	74	(3.7)
<b>INCOME (LOSS) BEFORE CONTRIBUTIONS</b>	3,499	1,366	2,133	156.1
<b>CONTRIBUTIONS</b>	1,334	1,500	(166)	(11.1)
<b>CHANGE IN NET ASSETS</b>	<b>\$ 4,833</b>	<b>\$ 2,866</b>	<b>\$ 1,967</b>	<b>68.6</b>
<b>CAPITAL EXPENDITURES (NET OF CONTRIBUTIONS)</b>				
Electric	\$ 29,144	\$ 37,314	\$ (8,170)	(21.9)
Telecommunications	1,725	1,859	(134)	(7.2)
Internet	62	77	(15)	(19.5)
Total Capital Expenditures	\$ 30,931	\$ 39,250	\$ (8,319)	(21.2)

EPB's operating budget for FY 2004 was prepared prior to TVA's October 2003 rate increase. At the time revenue and purchased power budgets were being prepared, the certainty of TVA's rate increase was unknown. The differences in the Electric System's sales and operating expenses are primarily due to TVA's rate increase.

Although the Telecommunications System continued to grow, increased competition in the Chattanooga market resulted in less than expected revenues. Reduced sales also resulted in less than expected telecommunications operating costs.

The Internet System grew faster than anticipated resulting in revenues being higher than expected. However, higher than budgeted contract labor costs resulted in operating expenses also being more than expected.

As shown in Table 3, Capital Expenditures on the Electric System were \$8.2 million less than budgeted. Most of this variance is the result of timing surrounding the payments that EPB would make to the new office building and garage contractor in FY 2004. After the budget for FY 2004 was completed, a detailed completion and payment schedule was received from the contractor that projected payments of \$11.8 million instead of the \$18.0 million budgeted. The remainder of this variance is the result of complications in constructing the footings and pilings for the new office building and garage that resulted in an approximate three month delay in the payment schedule.

## UTILITY PLANT

At the end of FY 2004, EPB had \$252.9 million in net utility plant as shown in Table 4. This represents a broad range of infrastructure for the purpose of providing services to our customers. Examples include transformers, meters, conductors, conduit, poles and fixtures, control equipment, switching equipment, telecommunications central office switch, vehicles and equipment.

**Table 4**  
**Utility Plant** (IN THOUSANDS OF DOLLARS)

	FY 2004	FY 2003	DOLLAR CHANGE	TOTAL PERCENT CHANGE
<b>ELECTRIC</b>				
Transmission	\$ 52,318	\$ 50,740	\$ 1,578	3.1
Distribution	292,166	280,529	11,637	4.1
Land & land rights	3,079	4,150	(1,071)	(25.8)
Buildings & improvements	16,110	15,336	774	5.0
Furniture, fixtures & equipment	31,017	27,813	3,204	11.5
Construction work in progress	17,678	8,453	9,225	109.1
	412,368	387,021	25,347	6.5
Less: Accumulated depreciation	(172,015)	(161,613)	(10,402)	6.4
<b>Electric Total</b>	<b>240,353</b>	<b>225,408</b>	<b>14,945</b>	<b>6.6</b>
<b>TELECOMMUNICATIONS</b>				
Central Office equipment	6,634	6,024	610	10.1
Information origination/termination	6,148	5,392	756	14.0
Cable & wire facilities	3,323	2,970	353	11.9
Furniture, fixtures & equipment	1,277	1,216	61	5.0
Leasehold improvements	139	165	(26)	(15.8)
Construction work in progress	61	90	(29)	(32.2)
	17,582	15,857	1,725	10.9
Less: Accumulated depreciation	(5,122)	(3,545)	(1,577)	44.5
<b>Telecommunications Total</b>	<b>12,460</b>	<b>12,312</b>	<b>148</b>	<b>1.2</b>
<b>INTERNET</b>				
Internet equipment	62	—	62	100.0
Construction work in progress	—	—	—	—
	62	—	62	100.0
Less: Accumulated depreciation	(6)	—	(6)	100.0
<b>Internet Total</b>	<b>56</b>	<b>—</b>	<b>56</b>	<b>100.0</b>
<b>NET UTILITY PLANT</b>	<b>\$ 252,869</b>	<b>\$ 237,720</b>	<b>\$ 15,149</b>	<b>6.4</b>

## DEBT ADMINISTRATION

EPB did not issue any new debt during FY 2004 and did not draw on any lines of credit during the year. New debt issuance in FY 2005 is not planned.

As of year-end, EPB Electric System had \$35.2 million in debt outstanding compared to \$36.8 million last year, a 4.3% decrease due to debt retirement. The outstanding debt is a part of EPB's \$40 million series 2000 revenue bonds. These bonds were rated AA by Fitch, and AA by Standard & Poor's. More detailed information about EPB's long-term debt is shown in Note 6 of the financial statements.

One area that demonstrates EPB's financial strength and future borrowing capability is seen in its debt coverage ratio. The City of Chattanooga has a requirement that if this ratio should ever decrease below 1.5, EPB would be required to establish and fund a reserve fund. EPB's bonds are electric revenue bonds, so debt coverage ratio as it relates to the electric system is shown in Table 5. This ratio is currently a strong 8.6.

**Table 5**  
**Electric System**  
**Debt Coverage Analysis (IN THOUSANDS OF DOLLARS)**

	FY 2004	FY 2003
<b>REVENUES</b>		
Electric Revenue	\$ 366,758	\$ 354,844
Interest Income	1,081	1,501
Other Income	1,050	1,121
Total Revenue	368,889	357,466
<b>EXPENSES</b>		
Purchased Power	295,544	284,700
Operating Expenses	43,927	46,098
Total Operation Expenses (excluding depreciation and taxes)	339,471	330,798
<b>FUNDS AVAILABLE FOR DEBT SERVICE</b>	<b>\$ 29,418</b>	<b>\$ 26,668</b>
<b>DEBT SERVICE</b>		
Interest on Long-Term Debt	\$ 1,810	\$ 1,880
Principal Payments	1,600	1,600
Total Debt Service	\$ 3,410	\$ 3,480
<b>DEBT COVERAGE RATIO</b>	<b>8.6</b>	<b>7.7</b>

**ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES**

EPB's Board of Directors and Management considered many factors when setting FY 2005 budget and rates. One of those factors is the local economy, and the impact its rates have on local industries. The economic outlook in EPB's service area generally calls for slow growth during FY 2005. EPB's FY 2005 budget is based on a seven year statistical trend analysis with no rate increases. By maintaining competitive rates, EPB believes it can help local industries remain competitive in their respective markets.

A contract, with an approved budget of \$26 million, for the new headquarters and accompanying 500 car parking garage, was approved during FY 2003 by the EPB Board of Directors. EPB's budget for FY 2005 projects the completion of this contract.

**CONTACTING EPB'S FINANCIAL MANAGER**

This report is designed to provide our customers and creditors with a general overview of EPB's finances and to demonstrate EPB's accountability for the money it receives. If you have questions about this report or need additional financial information, contact EPB - Finance Division, P. O. Box 182255, Chattanooga, TN 37422-7255.



## REPORT OF INDEPENDENT AUDITORS

### **The Board of Directors Electric Power Board of Chattanooga**

We have audited the accompanying financial statements of the **ELECTRIC POWER BOARD OF CHATTANOOGA** ("EPB," a component unit of the City of Chattanooga) and the supplemental information for the Electric, Telecommunications and Internet Systems as of and for the years ended June 30, 2004 and 2003. These financial statements are the responsibility of the management of EPB. 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 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 opinion.

These financial statements present only EPB and are not intended to present fairly the financial position of the City of Chattanooga and the results of its operations and the cash flows of its proprietary fund types and nonexpendable trust funds 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 EPB as of June 30, 2004 and 2003, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States.

In accordance with *Government Auditing Standards*, we have also issued our report, dated August 2, 2004, on our consideration of EPB's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Management's discussion and analysis on pages 32 through 40 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

The logo for Ernst & Young LLP is written in a stylized, cursive script. The word "Ernst" is followed by an ampersand, then "Young", and "LLP" is at the end.

Chattanooga, Tennessee  
August 2, 2004

BALANCE SHEETS  
JUNE 30, 2004 AND 2003

	2004	2003
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 42,343,000	\$ 30,085,000
Accounts receivable, less allowance for doubtful accounts of \$599,000 and \$750,000 in 2004 and 2003, respectively	12,204,000	12,206,000
Unbilled electric sales	22,384,000	18,385,000
Conservation loans receivable	373,000	562,000
Investments - net, unrestricted	28,768,000	31,212,000
Materials and supplies, at average cost	4,980,000	5,657,000
Prepayments and other current assets	3,034,000	1,822,000
	<u>114,086,000</u>	<u>99,929,000</u>
<b>NON-CURRENT ASSETS</b>		
Investments - net	—	12,645,000
Utility plant -		
Utility plant	430,012,000	402,878,000
Less - accumulated provision for depreciation	(177,144,000)	(165,158,000)
Other Assets -		
Deferred charges and other non-current assets	1,743,000	134,000
Unamortized bond issue cost	370,000	387,000
TVA discounted energy units	4,375,000	4,875,000
Conservation loans receivable	876,000	1,386,000
	<u>260,232,000</u>	<u>257,147,000</u>
<b>TOTAL ASSETS</b>	<u>\$ 374,318,000</u>	<u>\$ 357,076,000</u>
<b>LIABILITIES AND NET ASSETS</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable -		
Tennessee Valley Authority, for power purchased	53,787,000	44,048,000
Other	6,009,000	4,673,000
Customer deposits	12,539,000	11,537,000
Conservation loans	384,000	607,000
Revenue bonds, current portion	1,600,000	1,600,000
Accrued tax equivalents	8,615,000	8,897,000
Accrued interest payable	2,406,000	2,439,000
Other current liabilities	5,085,000	3,897,000
	<u>90,425,000</u>	<u>77,698,000</u>
<b>NON-CURRENT LIABILITIES</b>		
Revenue bonds - net	33,539,000	35,136,000
Accrued postretirement benefit obligation	10,269,000	10,378,000
Deferred credits	4,162,000	2,255,000
Conservation loans	902,000	1,421,000
	<u>48,872,000</u>	<u>49,190,000</u>
<b>NET ASSETS</b>		
Invested in utility plant, net of related debt	218,100,000	201,369,000
Unrestricted	16,921,000	28,819,000
	<u>235,021,000</u>	<u>230,188,000</u>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<u>\$ 374,318,000</u>	<u>\$ 357,076,000</u>

(The accompanying Notes to Financial Statements are an integral part of these statements.)

STATEMENTS OF REVENUES, EXPENSES  
AND CHANGES IN NET ASSETS  
FOR THE YEARS ENDED JUNE 30, 2004 AND 2003

	2004	2003
<b>OPERATING REVENUES</b>		
Electric sales		
Residential	\$ 145,033,000	\$ 142,357,000
Small commercial and power	27,396,000	26,243,000
Large commercial and power	179,568,000	175,880,000
Outdoor lighting systems	4,929,000	4,745,000
Total billed electric sales	356,926,000	349,225,000
Change in unbilled electric sales	3,999,000	50,000
Less uncollectible electric sales	(418,000)	(451,000)
Total electric sales	360,507,000	348,824,000
Other operating revenues		
Telecommunications revenues	10,669,000	9,000,000
Less uncollectible telecommunications revenues	(87,000)	(189,000)
Internet revenues	78,000	37,000
Less uncollectible internet revenues	—	(37,000)
Other operating revenues	6,074,000	5,930,000
Total other operating revenues	16,734,000	14,741,000
Total operating revenues	377,241,000	363,565,000
<b>OPERATING EXPENSES</b>		
Operation		
Power purchased from Tennessee Valley Authority	295,544,000	284,700,000
Other operation expenses	30,788,000	31,728,000
Maintenance	12,809,000	14,095,000
Telecommunication operating expenses	8,807,000	7,992,000
Internet operating expenses	134,000	37,000
Provision for depreciation	15,093,000	14,630,000
City, County and State tax equivalents	8,648,000	8,935,000
Total operating expenses	371,823,000	362,117,000
Net operating revenues	5,418,000	1,448,000
<b>OTHER REVENUES (DEDUCTIONS)</b>		
Interest income on invested funds	1,081,000	1,501,000
Interest expense on long-term debt	(1,572,000)	(1,880,000)
Other income	61,000	53,000
Other expense	(155,000)	(185,000)
Plant cost recovered through contributions in aid of construction	(1,334,000)	(1,058,000)
Total other revenues (deductions)	(1,919,000)	(1,569,000)
<b>INCOME (LOSS) BEFORE CONTRIBUTIONS</b>	3,499,000	(121,000)
<b>CONTRIBUTIONS IN AID OF CONSTRUCTION</b>	1,334,000	1,058,000
<b>CHANGE IN NET ASSETS</b>	4,833,000	937,000
<b>NET ASSETS, BEGINNING OF YEAR</b>	230,188,000	229,251,000
<b>NET ASSETS, END OF YEAR</b>	\$ 235,021,000	\$ 230,188,000

(The accompanying Notes to Financial Statements are an integral part of these statements.)

STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2004 AND 2003

	2004	2003
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts from customers	\$ 373,433,000	\$ 367,018,000
Receipts from vendors	998,000	272,000
Payments to suppliers for goods and services	(315,244,000)	(320,723,000)
Payments to employees for services	(20,250,000)	(22,925,000)
Payments in lieu of taxes	(8,935,000)	(8,605,000)
Net cash provided by operating activities	30,002,000	15,037,000
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Additions to utility plant	(30,901,000)	(21,166,000)
Removal cost	(1,169,000)	(900,000)
Salvage	43,000	243,000
Contributions in aid of construction	1,334,000	1,058,000
Bond principal payment	(1,600,000)	(1,600,000)
Bond interest payment	(1,813,000)	(1,887,000)
Net cash used in capital and related financing activities	(34,106,000)	(24,252,000)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Interest on investments	667,000	317,000
Sale/purchase of certificates of deposit, net	(3,500,000)	600,000
Sale of investments	19,195,000	—
Net cash provided by investing activities	16,362,000	917,000
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>12,258,000</b>	<b>(8,298,000)</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<b>30,085,000</b>	<b>38,383,000</b>
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<b>\$ 42,343,000</b>	<b>\$ 30,085,000</b>
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>		
Net operating revenues	\$ 5,415,000	\$ 1,448,000
Adjustments to reconcile net operating revenues to net cash provided by operating activities:		
Depreciation and amortization	15,780,000	15,393,000
Changes in assets and liabilities:		
Accounts receivable, net	155,000	2,552,000
Unbilled electric sales	(3,999,000)	(50,000)
Materials and supplies	677,000	1,175,000
Prepayments and other current assets	(1,522,000)	356,000
TVA discounted energy units	500,000	(5,000,000)
Deferred charges	(1,813,000)	(98,000)
Conservation loans receivable	698,000	1,004,000
Accounts payable, net	11,083,000	(2,366,000)
Customer deposits	1,002,000	1,124,000
Accrued tax equivalents	(281,000)	329,000
Other current liabilities	1,186,000	298,000
Deferred credits	1,971,000	83,000
Conservation loans	(741,000)	(1,011,000)
Accrued postretirement benefit obligation	(109,000)	(200,000)
Net cash provided by operating activities	\$ 30,002,000	\$ 15,037,000

(The accompanying Notes to Financial Statements are an integral part of these statements.)

## 1. GENERAL

The Electric Power Board of Chattanooga is a municipal utility and a component unit of the City of Chattanooga, Tennessee. In 1999, the Electric Power Board began doing business as EPB. EPB began electric operations (the “Electric System”) in 1939 and provides electricity to customers in the City of Chattanooga and surrounding counties, including Northwest Georgia. The Tennessee Valley Authority is EPB’s primary provider of power and acts in a regulatory capacity in setting electric rates. In 1999, EPB received approval from the Tennessee Regulatory Authority under the authority of Tennessee Code Annotated ¶7-52-401 to provide telecommunications services and created the Telecommunications System. In May 2002, EPB received necessary approvals from the State of Tennessee in accordance with Tennessee Code Annotated ¶7-52-601, *et seq.* and 7-52-103(c) to provide internet services. On July 16, 2002, the City Council of the City of Chattanooga approved and authorized EPB’s Internet System to provide these services. Supplementary data for the Electric System, Telecommunications System and Internet System is shown in Supplemental Information.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### BASIS OF ACCOUNTING

The accompanying financial statements of EPB include the accounts of the Electric System, the Telecommunications System and the Internet System (collectively EPB). All significant intersystem transactions and balances have been eliminated in the financial statements of EPB.

Where applicable, the Electric System’s accounting records generally follow the Federal Energy Regulatory Commission’s Uniform System of Accounts Prescribed for Public Utilities, and the Telecommunications System’s accounting records generally follow the Federal Communications Commission’s Uniform System of Accounts for Telecommunications Companies.

Under Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, EPB has elected to apply all Financial Accounting Standards Board (FASB) Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements, to EPB’s accounting and financial reporting. EPB conforms to the provisions of Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*. SFAS No. 71 allows for the reduction of plant cost recovered through contributions in aid of construction as opposed to recovery of costs through future regulatory rates.

In 2003, EPB implemented SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, which superseded SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed of*. SFAS No. 144 establishes accounting standards for the

assessment, measurement and reporting of the impairment of all long-lived assets. Under this statement, impaired long-lived assets are reported at the lower of their carrying value or estimated fair value, less selling cost. The adoption of this statement did not have an impact on EPB's financial condition or results of operations.

In 2004, EPB implemented GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, and SFAS No. 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits*. GASB Statement No. 42 establishes guidance for accounting and reporting for the impairment of capital assets and for insurance recoveries. It defines asset impairment as "a significant, unexpected decline in the service utility of a capital asset." SFAS No. 132 (revised 2003) replaces SFAS No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits*. SFAS No. 132 (revised 2003) retains the disclosure requirements contained in the original SFAS No. 132 and requires additional disclosures about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other defined postretirement plans. The adoption of these statements did not have an impact on EPB's financial condition or results of operations.

#### USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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 expenses during the reporting period. Actual results could differ from those estimates.

#### CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand, deposits in banks, and short-term, highly liquid investments with an original maturity date of three months or less.

#### FINANCIAL INSTRUMENTS

Financial instruments of EPB include cash, certificates of deposit, a money-market account, long and short-term investments in federal agency bonds and notes, investment in the State of Tennessee Local Government Investment Pool, accounts receivable, and various current liabilities. Short-term investments in federal agency bonds and notes with a maturity of one year or less are carried at amortized cost. The carrying value of all other financial instruments approximated market value at June 30, 2004 and 2003.

#### MATERIALS AND SUPPLIES

Materials and supplies inventory is valued at the lower of cost or market using the average cost basis.

## UTILITY PLANT

Utility plant is stated at original cost. Such costs include applicable general and administrative costs and payroll-related costs such as pensions, taxes, and other benefits.

EPB provides depreciation at rates which are designed to amortize the cost of depreciable utility plant over its estimated useful life. The composite straight-line rate, expressed as a percentage of average depreciable utility plant was 3.91% in 2004 and 3.98% in 2003.

When property subject to depreciation is retired or otherwise disposed of in the normal course of business, its original cost, together with its cost of removal less salvage, is charged to the accumulated provision for depreciation. EPB charges maintenance and repairs, including the cost of renewals of minor items of property, to maintenance expense accounts or applicable clearing accounts. Placements of property (exclusive of minor items of property) are capitalized to utility plant accounts.

## ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION (AFUDC)

AFUDC represents the approximate net composite interest cost of borrowed funds and a reasonable return on the equity funds used for construction. For FY 2004 and FY 2003, AFUDC increased both the plant balance and other revenue by \$238,000 and \$0, respectively. It is EPB policy that any single capital project with an estimated cost of \$2 million or more will receive AFUDC.

## REVENUES AND EXPENSES

Revenues are recognized on the accrual basis at the time utility services are provided. Operating revenues include receipts from utility sales and miscellaneous revenue related to utility operations. This includes late payment fees, rental income and ancillary services. Operating expenses include those expenses that result from the ongoing operations of the utility systems.

Non-operating revenues consist primarily of investment income. Also, contributions in aid of construction are non-operating revenues. Non-operating expenses consist of interest expense on long-term indebtedness, plant cost recovered through contributions in aid of construction, and miscellaneous expenses not directly identified with the utility systems operations.

## ACCOUNTS RECEIVABLE

EPB periodically reviews accounts receivable for amounts it considers as uncollectible and provides an allowance for doubtful accounts. Current earnings are charged with an allowance for doubtful accounts based on a percent of gross revenue determined from historical net bad debt experience. Accounts considered uncollectible throughout the year are charged against the allowance.



### ADVERTISING COST

Costs related to advertising for the Electric System, Telecommunications System, and Internet System are expensed in the fiscal year in which related advertising takes place. Advertising expense for FY 2004 and FY 2003 was \$1,646,000 and \$1,280,000, respectively.

## 3. DEPOSITS AND INVESTMENTS

It is EPB's policy to invest excess cash only in certificates of deposit, repurchase agreements, money-market accounts with local depository institutions, the State of Tennessee Local Government Investment Pool (LGIP), U. S. Treasury obligations, federal agency obligations, and municipal bonds.

At June 30, 2004 and 2003, EPB's deposits, money-market accounts with local depository institutions, and investments in certificates of deposit were entirely covered by either the Federal Depository Insurance Corporation insurance, collateral held by the City Treasurer on behalf of EPB, or insured by the State of Tennessee Collateral Pool for Public Deposits.

Also, at June 30, 2004 and 2003, portions of EPB's investments were held in the State of Tennessee LGIP. The legislation providing for the establishment of the LGIP (Tennessee Code Annotated ¶9-4-701 *et seq.*) authorizes investment in the LGIP for local governments and other political subdivisions. The LGIP is sponsored by the State of Tennessee Treasury Department, and is a part of the State Pooled Investment Fund.

As of June 30, 2004 and 2003, EPB had certificates of deposit of \$21,100,000 and \$0, respectively, and money-market funds of \$4,011,000 and \$12,246,000, respectively. The amount in the State of Tennessee Local Government Investment Pool as of June 30, 2004 and 2003 was \$18,245,000 and \$13,559,000, respectively. Additionally, the amounts in U. S. Treasury obligations and federal agency obligations at June 30, 2004 and 2003 were \$25,268,000 and \$43,857,000, respectively. All such amounts are included in cash and cash equivalents and investments at June 30, 2004 and 2003.

Investments are categorized into three credit risk categories by GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*. All of EPB's deposits and investments (excluding the LGIP) meet the requirements of the first category, defined by GASB to include investments which are insured or registered or securities held by EPB or its agents in EPB's name. Investment pools, such as the LGIP, are not categorized because they are not evidenced by securities that exist in physical or book entry form.

**4. UTILITY PLANT**

Electric utility plant assets activity for the year ended June 30, 2004, was as follows:

<b>ELECTRIC</b>	<b>JUNE 30, 2003</b>	<b>ADDITIONS</b>	<b>RETIREMENTS &amp; OTHER</b>	<b>JUNE 30, 2004</b>
Transmission	\$ 50,740,000	\$ 1,706,000	\$ (128,000)	\$ 52,318,000
Distribution	280,529,000	14,484,000	(2,847,000)	292,166,000
Land & land rights	4,150,000	19,000	(1,090,000)	3,079,000
Buildings & improvements	15,336,000	844,000	(70,000)	16,110,000
Furniture, fixtures & equipment	27,813,000	3,663,000	(459,000)	31,017,000
Construction work in progress	8,453,000	9,738,000	(513,000)	17,678,000
<b>Electric Total</b>	<b>\$ 387,021,000</b>	<b>\$ 30,454,000</b>	<b>\$ (5,107,000)</b>	<b>\$ 412,368,000</b>

Telecommunications plant assets activity for the year ended June 30, 2004, was as follows:

<b>TELECOMMUNICATIONS</b>	<b>JUNE 30, 2003</b>	<b>ADDITIONS</b>	<b>RETIREMENTS &amp; OTHER</b>	<b>JUNE 30, 2004</b>
Central office equipment	\$ 6,024,000	\$ 610,000	\$ —	\$ 6,634,000
Information origination/termination	5,392,000	737,000	19,000	6,148,000
Cable & wire facilities	2,970,000	370,000	(17,000)	3,323,000
Furniture, fixtures & equipment	1,216,000	61,000	—	1,277,000
Leasehold improvements	165,000	—	(26,000)	139,000
Construction work in progress	90,000	—	(29,000)	61,000
<b>Telecommunications Total</b>	<b>\$ 15,857,000</b>	<b>\$ 1,778,000</b>	<b>\$ (53,000)</b>	<b>\$ 17,582,000</b>

Internet plant assets activity for the year ended June 30, 2004, was as follows:

<b>INTERNET</b>	<b>JUNE 30, 2003</b>	<b>ADDITIONS</b>	<b>RETIREMENTS &amp; OTHER</b>	<b>JUNE 30, 2004</b>
Internet equipment	\$ —	\$ 62,000	\$ —	\$ 62,000
Construction work in progress	—	—	—	—
<b>Internet Total</b>	<b>\$ —</b>	<b>\$ 62,000</b>	<b>\$ —</b>	<b>\$ 62,000</b>

<b>Total Utility Plant</b>	<b>\$ 402,878,000</b>	<b>\$ 32,294,000</b>	<b>\$ (5,160,000)</b>	<b>\$ 430,012,000</b>
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The estimated useful lives of capital assets are as follows:

Transmission	10-40 years
Distribution	10-40 years
Buildings and structures	40 years
Furniture, fixtures, and equipment	5-20 years
Central office equipment	25 years
Information origination / termination	5-10 years
Cable and wire facilities	25 years
Leasehold improvements	10 years
Internet equipment	2.5-5 years

Depreciation expense for the Electric System was \$13,512,000 and \$13,226,000 for the fiscal years ended June 30, 2004 and 2003, respectively. Depreciation expense for the Telecommunications System was \$1,576,000 and \$1,404,000 for the fiscal years ended June 30, 2004 and 2003, respectively. Depreciation expense for the Internet System was \$7,000 and \$0 for the fiscal years ended June 30, 2004 and 2003, respectively.

## 5. TENNESSEE VALLEY AUTHORITY PROGRAMS

EPB is a fiscal intermediary for the Tennessee Valley Authority's (TVA) conservation programs. As of June 30, 2004 and 2003, outstanding conservation loan advances totaled \$1,286,000 and \$2,027,000, respectively, used by EPB for customer loans in connection with TVA's insulation and heat pump conservation programs. At June 30, 2004 and 2003, the outstanding receivables for the loans made from these funds amounted to \$1,249,000 and \$1,947,000, respectively. A total of approximately \$78,417,000 has been loaned to EPB's customers since the programs were begun in 1977. Effective June 30, 1997, TVA sold its loans to AmSouth (formerly First American National Bank). This sale changed the parties to the arrangement described above but does not change EPB's role as fiscal intermediary.

EPB participates in the TVA Discounted Energy Units (DEU) program. The DEU program allows TVA distributors to prepay a portion of the price of a block of kilowatt hours yet to be supplied by TVA, each such block being a DEU, and receive a discount over a defined period of years. In 2003, EPB purchased 5.0 DEU's by paying \$5,000,000. Under this program, EPB will recover this prepayment over a ten year period through a monthly discount of 2.50¢ per kWh on the specified monthly kWh DEU portion of firm energy purchased from TVA in that month. At June 30, 2004 and 2003, the outstanding DEU balance was \$4,375,000 and \$4,875,000, respectively.

**6. LONG-TERM DEBT AND LONG-TERM LIABILITIES**

On September 26, 2000, EPB issued \$40,000,000 Electric System Revenue Bonds, Series 2000 with maturity ranging from September 1, 2002 through September 1, 2025. Interest rates vary between 4.25 and 5.375%. The City of Chattanooga has a requirement that if the EPB debt coverage ratio (funds available for servicing debt divided by debt service) should be below 1.5, EPB will be required to establish and fund a reserve fund. The debt coverage ratio at June 30, 2004 was 8.6. Debt service requirements at June 30, 2004 are as follows:

FISCAL YEAR	PRINCIPAL	INTEREST	TOTAL
2005	\$ 1,600,000	\$ 1,741,000	\$ 3,341,000
2006	1,600,000	1,665,000	3,265,000
2007	1,600,000	1,589,000	3,189,000
2008	1,600,000	1,515,000	3,115,000
2009	1,600,000	1,443,000	3,043,000
2010-2014	8,000,000	6,079,000	14,079,000
2015-2019	8,000,000	4,029,000	12,029,000
2020-2024	8,000,000	1,926,000	9,926,000
2025-2026	3,200,000	172,000	3,372,000
<b>Total</b>	<b>\$ 35,200,000</b>	<b>\$ 20,159,000</b>	<b>\$ 55,359,000</b>

Activity in long-term liabilities for the year ended June 30, 2004, was as follows:

	JUNE 30, 2003	ADDITIONS DURING YEAR	DECREASES DURING YEAR	BALANCE OUTSTANDING JUNE 30, 2004	CURRENT AMOUNT DUE
Revenue Bonds payable	\$ 35,200,000	\$ —	\$ 1,600,000	\$ 33,600,000	\$ 1,600,000
Unamortized discount	\$ (64,000)	\$ 3,000	\$ —	\$ (61,000)	\$ —
Conservation loans	\$ 1,421,000	\$ 170,000	\$ 689,000	\$ 902,000	\$ 384,000

Sick leave liabilities are composed of short-term and long-term portions. Short-term sick leave liability is included in current liabilities in the other current liabilities category, and long-term sick leave liability is included in long-term liabilities in the deferred credits category. In 2002, the sick leave program was terminated, but employees were permitted to retain any accumulated sick leave hours. Under certain conditions employees may use sick leave hours. Annually, employees may elect to be paid at their current rate of pay for up to 48 hours of sick leave at the rate of one hour of pay for two hours of sick leave and, starting in fiscal year 2005, for up to an additional 16 hours of sick leave at the rate of one hour of pay for one hour of sick leave. The valuation of the hours eligible for this annual payment is considered a short-term liability. This short-term sick leave liability was \$243,000 and \$161,000 at June 30, 2004 and 2003, respectively. Also, employees were eligible to be paid upon retirement at the rate of 33% for accumulated sick leave hours at June 30, 2004 and 2003 at their current rate of pay. Total accumulated sick leave hours reduced by the hours eligible for annual payment is considered the hours eligible for pay upon retirement. The valuation of the hours eligible for pay upon retirement is considered a long-term liability. This long-term sick leave liability was \$1,021,000 and \$1,179,000 at June 30, 2004, and 2003, respectively.

## 7. EMPLOYEE BENEFIT PLANS

### PENSION PLAN

#### Plan Description

The Electric Power Board of Chattanooga Retirement Plan (the "Plan") is a single-employer defined benefit pension plan administered by an individual designated by EPB. The Plan provides retirement benefits to plan members. Article VIII of the Plan assigns the authority to establish and amend benefit provisions to EPB.

#### Funding Policy

The contribution requirements of plan members and EPB are established and may be amended by EPB. Plan members are not required to contribute to the Plan. EPB's contributions are calculated based on an actuarially determined rate, which is currently 9.71% of annual covered payroll.

#### Investment Policy

EPB's investment philosophy is to allocate the pension assets among common stocks, bonds, Guaranteed Insurance Contracts, and cash reserves. The use of covered call option writing contracts is also allowed. The table below lists the allowable asset mix of the fund.

	EQUITY	FIXED INCOME	CASH EQUIVALENTS
Minimum	20%	20%	0%
Maximum	80%	80%	35%

**Annual Pension Cost and Net Pension Obligation**

EPB's annual pension cost of the Plan for the current year was \$1,782,067 in 2004 and \$1,310,481 in 2003. Determined in accordance with GASB Statement No. 27, there is no net pension obligation as EPB has contributed the annual required contribution, adjusted with interest, as calculated by actuarial valuation. The annual required contribution was determined as part of an actuarial valuation performed as of August 1, 2003, using the aggregate cost method. Significant actuarial assumptions used in the valuation included (a) a rate of return on the investment of present and future assets of 8.0% per year compounded annually, (b) projected salary increases of 4.5% per year compounded annually, (c) no postretirement benefit increases, and (d) a discount rate of 8.0%. The estimated annual contribution for FY 2005 is \$1,910,000. The tables below show the funding progress for the pension plan for the past five years, employer contributions for the past five years, and the estimated future payments to the plan for the next 10 years.

**Schedule of Funding Progress for the Pension Plan**

ACTUARIAL VALUATION DATE	(1) ACTUARIAL VALUE OF PLAN ASSETS	(2) ACTUARIAL ACCRUED LIABILITY (AAL)	(3) UNFUNDED AAL (UAAL) (2) - (1)	(4) FUNDED RATIO (1) / (2)	(5) ANNUAL COVERED PAYROLL	(6) UAAL AS A % OF COVERED PAYROLL (3) / (5)
8/1/03	\$ 27,296,000	\$ 27,296,000	\$ —	100.0%	\$ 20,081,000	0.0%
8/1/02	42,946,000	42,946,000	—	100.0%	22,387,000	0.0%
8/1/01	44,472,000	44,472,000	—	100.0%	20,757,000	0.0%
8/1/00	42,262,000	42,262,000	—	100.0%	20,407,000	0.0%
8/1/99	43,113,000	43,113,000	—	100.0%	19,610,000	0.0%

**Schedule of Employer Contributions**

ACTUARIAL VALUATION DATE	ANNUAL REQUIRED CONTRIBUTION	ACTUAL CONTRIBUTION	PERCENTAGE CONTRIBUTED
8/1/03	\$ 1,983,553	\$ 1,983,553	100.0%
8/1/02	1,335,056	1,335,056	100.0%
8/1/01	1,068,089	1,068,089	100.0%
8/1/00	1,069,849	1,069,849	100.0%
8/1/99	738,239	738,239	100.0%

**Estimated Future Payments**

DATE	PENSION BENEFITS
2005	\$ 3,855,713
2006	2,407,254
2007	2,849,960
2008	4,539,072
2009	5,532,218
2010-2014	39,801,248

**401(k) PLAN**

Effective August 1, 1984, EPB implemented a 401(k) defined contribution plan which was amended May 1, 2004 to permit employees to invest up to 13.0% of their salary in a tax-deferred savings plan. After one year of employment, EPB contributes up to 3.0% of an employee's salary. All employees who have completed three months of employment and have attained age 18 are eligible to participate in the 401(k) defined contribution plan. Participating employees are immediately fully vested in EPB contributions, which amounted to approximately \$538,000 and \$618,000 in fiscal years 2004 and 2003, respectively. Employee contributions were \$1,560,000 and \$1,682,000 in fiscal years 2004 and 2003, respectively.

**8. POSTRETIREMENT BENEFITS**

Substantially all employees retiring from EPB are entitled to receive certain retirement health and life insurance benefits. These benefits are subject to deductibles, co-payment provisions, and other limitations.

Presently, EPB has the option of prefunding a Voluntary Employees' Beneficiary Association Trust (VEBA) to pay postretirement benefit claims. During 2004 and 2003, EPB had no additional funding to the VEBA for postretirement benefit claims. EPB's investment policy in the VEBA is to allocate its assets between equity, a minimum of 20% and a maximum of 80%, and bonds (which includes cash equivalents), a minimum of 20% and a maximum of 80%.

EPB accounts for postretirement health benefits in accordance with Statement of Financial Accounting Standards (SFAS) No. 106, which requires that the expected cost of the benefits be charged to expense during the years the employees render service. SFAS No. 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits*, retains the disclosure requirements contained in the original SFAS No. 132 and requires additional disclosures about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other defined postretirement plans.

The following table sets forth the amounts shown in EPB's balance sheets at June 30, 2004 and 2003, as the accrued postretirement benefit obligation:

	JUNE 30, 2004	JUNE 30, 2003
Benefit obligation	\$ 28,262,265	\$ 24,208,491
Fair value of plan assets	11,095,071	9,713,149
Funded status	\$ (17,167,194)	\$ (14,495,342)
Accrued postretirement benefit obligation recognized in the balance sheets	\$ (10,268,685)	\$ (10,377,801)
<b>WEIGHTED AVERAGE ASSUMPTIONS</b>		
Discount rate	7.00%	7.00%
Expected return on plan assets	8.00%	8.00%



For measurement purposes, a 7.5% and 8.0% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2004 and 2003, respectively. The rate at June 30, 2004 was assumed to decrease gradually by 0.5% per year until 5.0% is reached in the year 2009, after which it remains at 5.0%.

The following table sets forth the amounts for net periodic benefit cost, employer contributions, participant contributions, and benefits paid:

	JUNE 30, 2004		JUNE 30, 2003	
Benefit cost	\$	1,448,388	\$	1,273,478
Employer contributions	\$	1,557,504	\$	1,473,609
Participant contributions	\$	257,666	\$	191,384
Benefits paid	\$	1,815,170	\$	1,664,993

The estimated annual employer contribution for FY 2005 is \$1,600,000. The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

DATE	POSTRETIREMENT BENEFITS
2005	\$ 1,784,654
2006	\$ 1,819,617
2007	\$ 1,828,029
2008	\$ 1,818,487
2009	\$ 1,782,048
Years 2010-2014	\$ 9,005,758

## 9. LINE OF CREDIT

In 2004, EPB obtained a short-term line of credit with the execution of an Electric System Revenue Anticipation Note (Line of Credit) to First Tennessee Bank National Association. The purpose of the note is for financing the purchase of electric power. The note is payable from and secured by a pledge of the net revenues of the electric distribution system, subject to the prior pledge of such revenues in favor of the outstanding bonds. Under terms of the note, amounts may be advanced and readvanced so long as the total amount outstanding does not exceed \$10,000,000 and so long as the aggregate amount of all such advances during any twelve-month period does not exceed \$100,000,000. Any advance must be retired on or before twelve months from the date of issuance.

As of June 30, 2004, EPB had not received any advances related to this note.

## 10. COMMITMENTS AND CONTINGENCIES

EPB is party to a contract with TVA dated January 17, 1989, under which the Electric System purchases electric power and energy from TVA for resale. The contract may be terminated by either party at any time upon not less than ten years' prior written notice.

A contract, with an approved budget of \$26 million, for the new headquarters and accompanying 500 car parking garage was approved during FY 2003 by the EPB Board of Directors. As of June 30, 2004, EPB had incurred \$8,114,000 in expenses related to this contract for the new headquarters and accompanying parking garage.

EPB is presently involved in certain legal matters, the outcome of which is not presently determinable. It is the opinion of management, based in part on the advice of legal counsel, that these matters will not have a material adverse effect on the results of operations or the financial position of EPB.

## 11. RISK MANAGEMENT

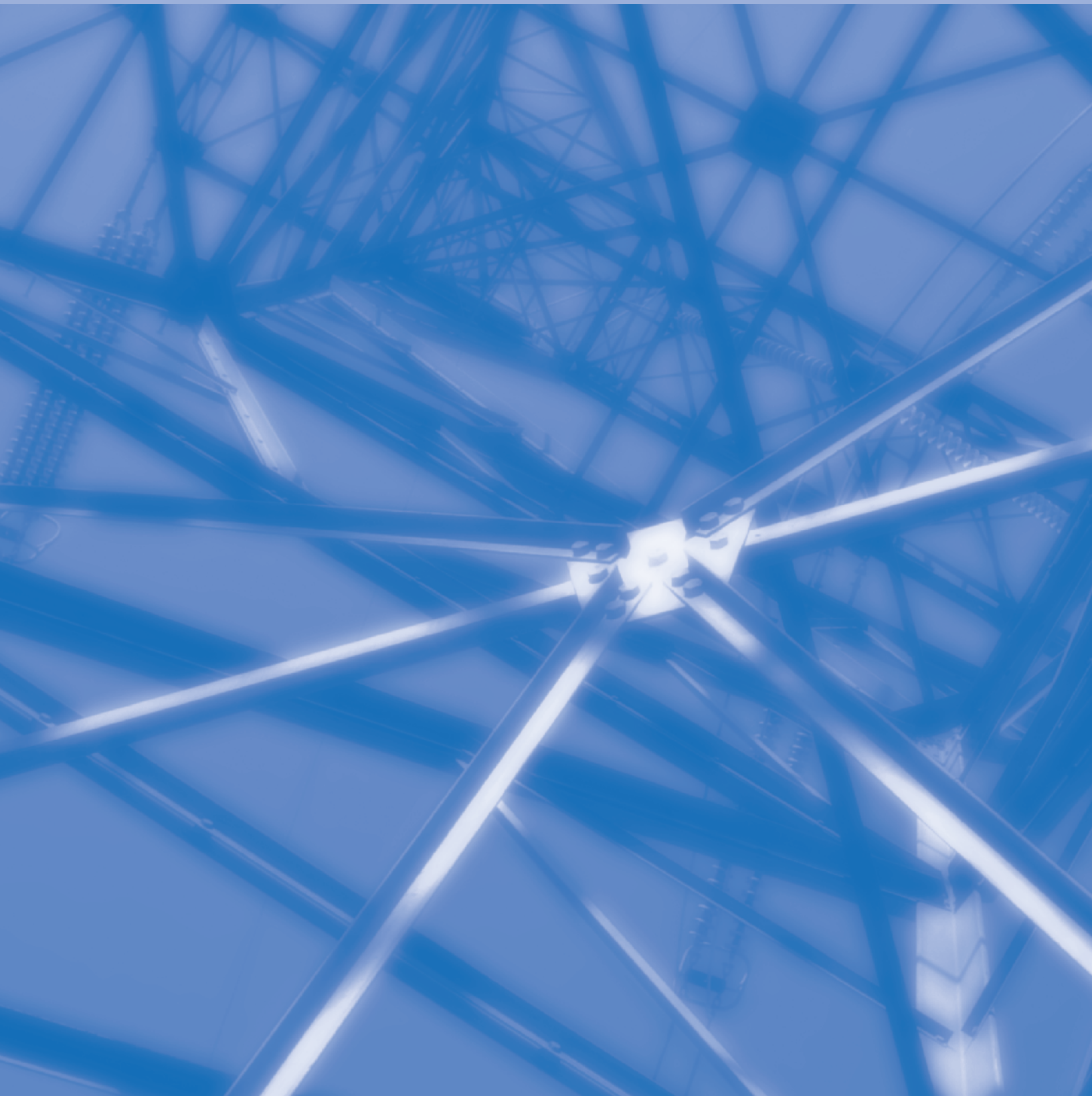
EPB is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; medical benefits; injuries to employees and natural disasters. EPB participates in the Distributors Insurance Company (DIC), a public entity risk pool, currently operating as a common risk management and insurance program for municipal utilities and electric cooperatives. EPB is self-insured for general liability claims up to \$500,000 per occurrence and for \$1,500,000 in the aggregate. EPB purchases commercial insurance for general liability claims in excess of its self-insured retention and for all other risks of loss. EPB also purchases commercial insurance to cover its workers' compensation and employer's liability exposure. Claims are subject to a deductible of \$300,000 per occurrence with a \$900,000 maximum. Settled claims have not exceeded this commercial coverage in any of the past three fiscal years. There are no significant claims liabilities outstanding at June 30, 2004 and 2003.

EPB's employee health plan is self funded, subject to stop loss insurance of \$100,000 per covered life and \$5,000,000 in the aggregate.

**12. FEDERAL EMERGENCY MANAGEMENT ASSISTANCE GRANT**

During May 2003, EPB sustained extensive power outages and line damage as a result of a flood. EPB incurred costs of approximately \$985,000 to restore power to approximately 7,800 customers. Due to the significance of the storm and the resulting damage, EPB applied for and was granted assistance from the Federal Emergency Management Agency (FEMA). At June 30, 2003, EPB included in other receivables in the financial statements a grant receivable from FEMA of approximately \$679,000. The \$679,000 represented 75% of the storm costs that met the FEMA criteria for reimbursement. During fiscal year 2004, EPB identified approximately \$13,000 of costs that had been included in the original FEMA claim that did not meet the FEMA criteria for reimbursement. Therefore, EPB adjusted its FEMA claim to approximately \$666,000. Subsequently, EPB received a payment of \$498,000 from FEMA as a partial reimbursement for costs incurred as a result of this storm. At June 30, 2004, EPB included in other receivables in the accompanying financial statements a grant receivable from FEMA of approximately \$168,000.

# Supplemental Information



	2004	2003
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 42,343,000	\$ 30,002,000
Accounts receivable, less allowance for doubtful accounts of \$531,000 and \$609,000 in 2004 and 2003, respectively	11,662,000	11,635,000
Unbilled electric sales	22,384,000	18,385,000
Conservation loans receivable	373,000	562,000
Investments - net	28,768,000	31,212,000
Materials and supplies, at average cost	4,980,000	5,657,000
Prepayments and other current assets	3,522,000	2,317,000
	<u>114,032,000</u>	<u>99,770,000</u>
<b>NON-CURRENT ASSETS</b>		
Investments - net	—	12,645,000
Notes receivable from Telecommunications System	25,006,000	23,785,000
Notes receivable from Internet System	157,000	37,000
Utility plant -		
Utility plant	412,368,000	387,021,000
Less - accumulated provision for depreciation	(172,016,000)	(161,613,000)
Other Assets -		
Deferred charges and other non-current assets	1,739,000	113,000
Unamortized bond issue cost	370,000	387,000
TVA discounted energy units	4,375,000	4,875,000
Conservation loans receivable	876,000	1,386,000
	<u>272,875,000</u>	<u>268,636,000</u>
<b>TOTAL ASSETS</b>	<u>\$ 386,907,000</u>	<u>\$ 368,406,000</u>
<b>LIABILITIES AND NET ASSETS</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable -		
Tennessee Valley Authority, for power purchased	\$ 53,787,000	\$ 44,048,000
Other	5,616,000	4,305,000
Customer deposits	12,539,000	11,537,000
Conservation loans	384,000	607,000
Revenue bonds, current portion	1,600,000	1,600,000
Accrued tax equivalents	8,132,000	8,453,000
Accrued interest payable	2,406,000	2,439,000
Other current liabilities	4,792,000	3,590,000
	<u>89,256,000</u>	<u>76,579,000</u>
<b>NON-CURRENT LIABILITIES</b>		
Revenue bonds - net	33,539,000	35,136,000
Accrued postretirement benefit obligation	10,269,000	10,378,000
Deferred credits	3,986,000	2,100,000
Conservation loans	902,000	1,421,000
	<u>48,696,000</u>	<u>49,035,000</u>
<b>NET ASSETS</b>		
Invested in utility plant, net of related debt	205,584,000	189,058,000
Unrestricted	43,371,000	53,734,000
	<u>248,955,000</u>	<u>242,792,000</u>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<u>\$ 386,907,000</u>	<u>\$ 368,406,000</u>

(The accompanying Notes to Financial Statements are an integral part of these statements.)

STATEMENTS OF REVENUES, EXPENSES  
AND CHANGES IN NET ASSETS  
FOR THE YEARS ENDED JUNE 30, 2004 AND 2003

	2004	2003
<b>OPERATING REVENUES</b>		
Electric sales		
Residential	\$ 145,033,000	\$ 142,357,000
Small commercial and power	27,396,000	26,243,000
Large commercial and power	179,568,000	175,880,000
Outdoor lighting systems	4,929,000	4,745,000
Total billed electric sales	356,926,000	349,225,000
Change in unbilled electric sales	3,999,000	50,000
Less uncollectible electric sales	(418,000)	(451,000)
Total electric sales	360,507,000	348,824,000
Other operating revenues	6,250,000	6,020,000
Total operating revenues	366,757,000	354,844,000
<b>OPERATING EXPENSES</b>		
Operation		
Power purchased from Tennessee Valley Authority	295,544,000	284,700,000
Other operation expenses	30,788,000	31,728,000
Maintenance	12,985,000	14,185,000
Provision for depreciation	13,511,000	13,226,000
City, County and State tax equivalents	8,170,000	8,491,000
Total operating expenses	360,998,000	352,330,000
Net operating revenues	5,759,000	2,514,000
<b>OTHER REVENUES (DEDUCTIONS)</b>		
Interest income on invested funds	1,081,000	1,501,000
Interest expense on long-term debt	(1,572,000)	(1,880,000)
Other income	1,050,000	1,121,000
Other expense	(155,000)	(185,000)
Plant cost recovered through contributions in aid of construction	(1,310,000)	(1,058,000)
Total other revenues (deductions)	(906,000)	(501,000)
<b>INCOME BEFORE CONTRIBUTIONS</b>	4,853,000	2,013,000
<b>CONTRIBUTIONS IN AID OF CONSTRUCTION</b>	1,310,000	1,058,000
<b>CHANGE IN NET ASSETS</b>	6,163,000	3,071,000
<b>NET ASSETS, BEGINNING OF YEAR</b>	242,792,000	239,721,000
<b>NET ASSETS, END OF YEAR</b>	\$ 248,955,000	\$ 242,792,000

(The accompanying Notes to Financial Statements are an integral part of these statements.)

STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2004 AND 2003

	<b>2004</b>	<b>2003</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts from customers	\$ 363,648,000	\$ 358,192,000
Payments to suppliers for goods and services	(308,774,000)	(315,120,000)
Payments to employees for services	(17,762,000)	(20,453,000)
Payments in lieu of taxes	(8,491,000)	(8,256,000)
Net cash provided by operating activities	<u>28,621,000</u>	<u>14,363,000</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Additions to utility plant	(29,090,000)	(19,721,000)
Removal cost	(1,169,000)	(900,000)
Salvage	43,000	243,000
Contributions in aid of construction	1,310,000	1,058,000
Bond principal payment	(1,600,000)	(1,600,000)
Bond interest payment	(1,813,000)	(1,887,000)
Net cash used in capital and related financing activities	<u>(32,319,000)</u>	<u>(22,807,000)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Interest on investments	667,000	317,000
Interest from notes receivable - Telecommunications System	1,017,000	1,104,000
Interest from notes receivable - Internet System	1,000	—
Purchase of certificates of deposit, net	(3,500,000)	—
Surrender of certificates of deposit, net	—	600,000
Notes receivable from Telecommunications System	(1,221,000)	(1,885,000)
Notes receivable from Internet System	(120,000)	(37,000)
Sale of investments	19,195,000	—
Net cash provided by investing activities	<u>16,039,000</u>	<u>99,000</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>12,341,000</b>	<b>(8,345,000)</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<u>30,002,000</u>	<u>38,347,000</u>
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<u><u>\$ 42,343,000</u></u>	<u><u>\$ 30,002,000</u></u>
<b>RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>		
Net operating revenues	\$ 5,759,000	\$ 2,514,000
Adjustments to reconcile net operating revenues to net cash provided by operating activities:		
Depreciation and amortization	14,198,000	13,991,000
Changes in assets and liabilities:		
Accounts receivable, net	126,000	2,490,000
Unbilled electric sales	(3,999,000)	(50,000)
Materials and supplies	677,000	1,175,000
Prepayments and other current assets	(1,538,000)	304,000
TVA discounted energy units	500,000	(5,000,000)
Deferred charges	(1,830,000)	(98,000)
Conservation loans receivable	698,000	1,004,000
Accounts payable, net	11,050,000	(2,569,000)
Customer deposits	1,002,000	1,124,000
Accrued tax equivalents	(321,000)	234,000
Other current liabilities	1,201,000	408,000
Deferred credits	1,948,000	47,000
Conservation loans	(741,000)	(1,011,000)
Accrued postretirement benefit obligation	(109,000)	(200,000)
Net cash provided by operating activities	<u><u>\$ 28,621,000</u></u>	<u><u>\$ 14,363,000</u></u>

(The accompanying Notes to Financial Statements are an integral part of these statements.)

	<b>2004</b>	<b>2003</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ —	\$ 83,000
Accounts receivable, less allowance for doubtful accounts of \$68,000 and \$141,000 in 2004 and 2003, respectively	532,000	571,000
Prepayments and other current assets	12,000	28,000
	<u>544,000</u>	<u>682,000</u>
<b>NON-CURRENT ASSETS</b>		
Utility plant -		
Utility plant	17,582,000	15,857,000
Less - accumulated provision for depreciation	(5,122,000)	(3,545,000)
Other assets -		
Deferred charges	4,000	21,000
	<u>12,464,000</u>	<u>12,333,000</u>
<b>TOTAL ASSETS</b>	<u>\$ 13,008,000</u>	<u>\$ 13,015,000</u>
<b>LIABILITIES AND NET ASSETS</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$ 393,000	\$ 368,000
Accrued tax equivalents	483,000	444,000
Accrued interest payable	491,000	522,000
Other current liabilities	293,000	307,000
	<u>1,660,000</u>	<u>1,641,000</u>
<b>NON-CURRENT LIABILITIES</b>		
Notes payable to Electric System	25,006,000	23,785,000
Deferred credits	173,000	155,000
	<u>25,179,000</u>	<u>23,940,000</u>
<b>NET ASSETS</b>		
Invested in utility plant, net of related debt	12,460,000	12,311,000
Unrestricted	(26,291,000)	(24,877,000)
	<u>(13,831,000)</u>	<u>(12,566,000)</u>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<u>\$ 13,008,000</u>	<u>\$ 13,015,000</u>

(The accompanying Notes to Financial Statements are an integral part of these statements.)



	<b>2004</b>	<b>2003</b>
<b>OPERATING REVENUES</b>		
Basic local services revenue	\$ 7,982,000	\$ 7,103,000
Long distance message revenue	1,017,000	796,000
Access revenue	514,000	680,000
Other revenue	1,156,000	421,000
Total operating revenue	10,669,000	9,000,000
Less uncollectible accounts	(87,000)	(189,000)
Total operating revenues	10,582,000	8,811,000
<b>OPERATING EXPENSES</b>		
Cost of services	3,563,000	3,461,000
Operation expenses	3,967,000	3,311,000
General and administrative	1,277,000	1,220,000
Provision for depreciation	1,576,000	1,404,000
City, County and State tax equivalents	478,000	444,000
Total operating expenses	10,861,000	9,840,000
Net operating loss	(279,000)	(1,029,000)
<b>OTHER DEDUCTIONS</b>		
Interest expense	(986,000)	(1,067,000)
Plant cost recovered through contributions in aid of construction	(24,000)	—
Total other deductions	(1,010,000)	(1,067,000)
<b>LOSS BEFORE CONTRIBUTIONS</b>	(1,289,000)	(2,096,000)
<b>CONTRIBUTIONS IN AID OF CONSTRUCTION</b>	24,000	—
<b>CHANGE IN NET ASSETS</b>	(1,265,000)	(2,096,000)
<b>NET ASSETS, BEGINNING OF YEAR</b>	(12,566,000)	(10,470,000)
<b>NET ASSETS, END OF YEAR</b>	\$ (13,831,000)	\$ (12,566,000)

(The accompanying Notes to Financial Statements are an integral part of these statements.)

STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2004 AND 2003

	<b>2004</b>	<b>2003</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts from customers	\$ 9,713,000	\$ 8,826,000
Receipts from vendors	998,000	272,000
Payments to suppliers for goods and services	(6,341,000)	(5,566,000)
Payments to employees for services	(2,488,000)	(2,472,000)
Payments in lieu of taxes	(444,000)	(349,000)
Net cash provided by operating activities	<u>1,438,000</u>	<u>711,000</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Additions to utility plant	(1,749,000)	(1,445,000)
Contributions in aid of construction	24,000	—
Interest on notes payable - Electric System	(1,017,000)	(1,104,000)
Notes payable to Electric System	<u>1,221,000</u>	<u>1,885,000</u>
Net cash used in capital and related financing activities	<u>(1,521,000)</u>	<u>(664,000)</u>
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<u><b>(83,000)</b></u>	<u><b>47,000</b></u>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	<u>83,000</u>	<u>36,000</u>
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	<u><u>\$ —</u></u>	<u><u>\$ 83,000</u></u>
<b>RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES</b>		
Net operating loss	\$ (279,000)	\$ (1,029,000)
Adjustments to reconcile net operating loss to net cash provided by operating activities:		
Depreciation and amortization	1,576,000	1,402,000
Changes in assets and liabilities:		
Accounts receivable, net	39,000	62,000
Prepayments and other current assets	16,000	52,000
Deferred charges	17,000	—
Accounts payable, net	25,000	203,000
Accrued tax equivalents	40,000	95,000
Other current liabilities	(15,000)	(110,000)
Deferred credits	<u>19,000</u>	<u>36,000</u>
Net cash provided by operating activities	<u><u>\$ 1,438,000</u></u>	<u><u>\$ 711,000</u></u>

(The accompanying Notes to Financial Statements are an integral part of these statements.)

BALANCE SHEETS  
JUNE 30, 2004 AND 2003

	<b>2004</b>	<b>2003</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Accounts receivable, less allowance for doubtful accounts of \$0 and \$37,000 in 2004 and 2003, respectively	\$ 10,000	\$ —
	<u>10,000</u>	<u>—</u>
<b>NON-CURRENT ASSETS</b>		
Utility plant -		
Utility plant	62,000	—
Less - accumulated provision for depreciation	<u>(6,000)</u>	<u>—</u>
	<u>56,000</u>	<u>—</u>
<b>TOTAL ASSETS</b>	<u>\$ 66,000</u>	<u>\$ —</u>
<b>LIABILITIES AND NET ASSETS</b>		
<b>CURRENT LIABILITIES</b>		
Accrued interest payable	\$ 9,000	\$ 1,000
	<u>9,000</u>	<u>1,000</u>
<b>NON-CURRENT LIABILITIES</b>		
Notes payable to Electric System	157,000	37,000
Deferred credits	<u>3,000</u>	<u>—</u>
	<u>160,000</u>	<u>37,000</u>
<b>NET ASSETS</b>		
Invested in utility plant, net of related debt	56,000	—
Unrestricted	<u>(159,000)</u>	<u>(38,000)</u>
	<u>(103,000)</u>	<u>(38,000)</u>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<u>\$ 66,000</u>	<u>\$ —</u>

(The accompanying Notes to Financial Statements are an integral part of these statements.)

STATEMENTS OF REVENUES, EXPENSES  
AND CHANGES IN NET ASSETS  
FOR THE YEARS ENDED JUNE 30, 2004 AND 2003

	<b>2004</b>	<b>2003</b>
<b>OPERATING REVENUES</b>		
Internet services	\$ 51,000	\$ —
Installation revenue	7,000	—
Bundle revenue	14,000	—
Other services	6,000	—
Management fee	—	37,000
Total operating revenue	78,000	37,000
Less uncollectible accounts	—	(37,000)
Total operating revenues	78,000	—
<b>OPERATING EXPENSES</b>		
Cost of services	35,000	—
Operation expenses	68,000	36,000
General and administrative	31,000	1,000
Provision for depreciation	6,000	—
Total operating expenses	140,000	37,000
Net operating loss	(62,000)	(37,000)
<b>OTHER DEDUCTIONS</b>		
Interest expense	(3,000)	(1,000)
Total other deductions	(3,000)	(1,000)
<b>CHANGE IN NET ASSETS</b>	(65,000)	(38,000)
<b>NET ASSETS, BEGINNING OF YEAR</b>	(38,000)	—
<b>NET ASSETS, END OF YEAR</b>	\$ (103,000)	\$ (38,000)

(The accompanying Notes to Financial Statements are an integral part of these statements.)

STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2004 AND 2003

	<b>2004</b>	<b>2003</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Receipts from customers	\$ 72,000	\$ —
Payments to suppliers for goods and services	(129,000)	(37,000)
Net cash used in operating activities	(57,000)	(37,000)
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Additions to utility plant	(62,000)	—
Interest on notes payable - Electric System	(1,000)	—
Notes payable to Electric System	120,000	37,000
Net cash provided by capital and related financing activities	57,000	37,000
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	—	—
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	—	—
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	\$ —	\$ —
<b>RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES</b>		
Net operating loss	(65,000)	(37,000)
Adjustments to reconcile net operating loss to net cash used in operating activities:		
Depreciation and amortization	6,000	—
Changes in assets and liabilities:		
Accounts receivable, net	(10,000)	—
Accounts payable, net	8,000	—
Deferred credits	4,000	—
Net cash used in operating activities	\$ (57,000)	\$ (37,000)

(The accompanying Notes to Financial Statements are an integral part of these statements.)

INDEPENDENT AUDITORS REPORT ON COMPLIANCE  
AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING

**The Board of Directors**  
**Electric Power Board of Chattanooga**

We have audited the financial statements of the **ELECTRIC POWER BOARD OF CHATTANOOGA** ("EPB," a component unit of the City of Chattanooga) as of and for the year ended June 30, 2004, and have issued our report thereon dated August 2, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

***Compliance***

As part of obtaining reasonable assurance about whether EPB's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, 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 that are required to be reported under *Government Auditing Standards*.

***Internal Control Over Financial Reporting***

In planning and performing our audit, we considered EPB's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Board of Directors, audit committee, management of EPB, and the Department of Audit of the State of Tennessee and is not intended to be and should not be used by anyone other than these specified parties.

*Ernst & Young LLP*

Chattanooga, Tennessee  
August 2, 2004



**Energy • Communications • Community**