ELECTRIC POWER BOARD OF THE
METROPOLITAN GOVERNMENT
OF NASHVILLE AND DAVIDSON COUNTY

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INDEPENDENT AUDITORS' REPORT

Members of the
Electric Power Board of the
Metropolitan Government of
Nashville and Davidson County
Nashville, Tennessee

We have audited the accompanying statement of net assets of the Electric Power Board of the Metropolitan Government of Nashville and Davidson County (the "Board"), a component unit of the Metropolitan Government of Nashville and Davidson County, Tennessee, as of June 30, 2005 and 2004, and the related statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Board's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Board as of June 30, 2005 and 2004, and the changes in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Board's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

November 16, 2005

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL OPERATIONS 2005

As financial management of the Electric Power Board of the Metropolitan Government of Nashville and Davidson County (the "Board"), we offer readers of these financial statements this narrative overview and analysis of the financial activities of the Board for the fiscal years ended June 30, 2005 and 2004. In conducting the operations of the electric distribution system, the Board does business as Nashville Electric Service ("NES"). NES is a component unit of the Metropolitan Government of Nashville and Davidson County, Tennessee. This discussion and analysis is designed to assist the reader in focusing on the significant financial issues and activities and to identify any significant changes in financial position. We encourage readers to consider the information presented here in conjunction with the financial statements taken as a whole.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to NES' financial statements, which is composed of the basic financial statements and the notes to the financial statements. Since NES is composed of a single enterprise fund, no fund-level financial statements are shown.

BASIC FINANCIAL STATEMENTS

The basic financial statements are designed to provide readers with a broad overview of NES' finances, in a manner similar to that of a private-sector business.

The statements of net assets present information on NES' assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of NES is improving or deteriorating. Net assets increase when revenues exceed expenses. Increases to assets without a corresponding increase to liabilities results in increased net assets, which indicates an improved financial position.

The statements of revenues, expenses, and changes in net assets present information showing how NES' net assets changed during the fiscal year. All changes in net assets are reported as soon as the underlying event occurs, regardless of timing of related cash flows. Thus revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., earned but unused vacation leave).

The statement of cash flows presents changes in cash and cash equivalents, resulting from operating, financing, and investing activities. This statement presents cash receipts and cash disbursement information, without consideration for the earnings event, when an obligation arises, or depreciation of capital assets.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL OPERATIONS 2005 (continued)

SUMMARY OF CHANGES IN NET ASSETS

Net assets may serve, over time, as a useful indicator of NES' financial position. In the case of NES, assets exceeded liabilities by $360 million at June 30, 2005, and $356 million at June 30, 2004. The current year represents an increase of $4.4 million over the previous year.

The largest portion of NES' net assets reflects its investment in capital assets less any related debt used to acquire those assets that is still outstanding. NES uses these capital assets to provide service, and consequently, these assets are not available to liquidate liabilities or other spending.

An additional portion of NES' net assets represents resources that are subject to external restrictions on how they may be used. These restrictions include bond proceeds to be used for construction projects and reserve funds required by bond covenants.

STATEMENTS OF NET ASSETS	June 30,	
($000 OMITTED)	2005	2004
ASSETS		
CURRENT ASSETS	$139,980	$142,826
INVESTMENT OF RESTRICTED FUNDS	118,165	140,340
UTILITY PLANT	674,728	654,635
ENERGY CONSERVATION PROGRAMS' NOTES	1,646	2,377
UNAMORTIZED BOND ISSUANCE COSTS	2,839	3,036
OTHER NONCURRENT ASSETS	393	488
TOTAL	$937,751	$943,702

STATEMENTS OF NET ASSETS	June 30,	
($000 OMITTED)	2005	2004
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES	$104,103	$102,140
CURRENT LIABILITIES PAYABLE FROM RESTRICTED ASSETS	16,745	21,147
LONG-TERM DEBT	453,853	461,245
OTHER NONCURRENT LIABILITIES	2,759	3,239
NET ASSETS	360,291	355,931
TOTAL	$937,751	$943,702

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL OPERATIONS 2005 (continued)
LIQUIDITY AND CAPITAL RESOURCES

NES' ongoing sources of liquidity are operating cash flow and proceeds from tax-exempt bonds. On June 30, 2004, NES closed on the sale of $110.0 million Metropolitan Government of Nashville and Davidson County, Tennessee, Electric System Revenue Bonds, 2004 Series A. The purpose of the Bonds was to fund approximately 50% of NES' projected $181.0 million Capital Budget for the three fiscal years ending June 30, 2007. The remainder will be funded with operating revenues. During fiscal year 2005 NES drew down $23.7 million from these funds for capital expenditures. The remaining proceeds will be drawn down quarterly over the next two fiscal years.

NES has sufficient debt capacity and a strong financial position and, therefore, expects the tax-exempt bond market to be a future source of liquidity to supplement the cash flow from operations.

In addition to operating cash flow and proceeds from tax-exempt bonds, NES has a $25.0 million line of credit, which is renewed each year. The credit facility is not a source of liquidity for ongoing operations but is available as an additional funding source in the event of a natural catastrophe.

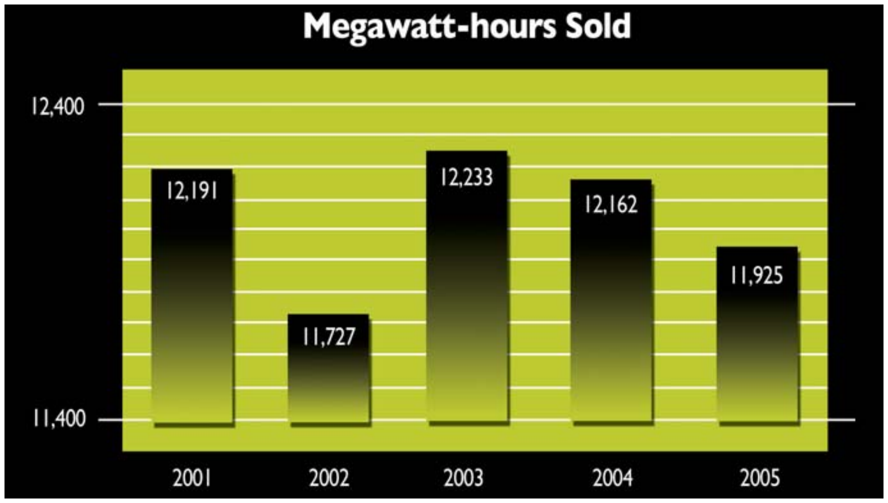
In order to maintain its strong credit ratings, NES has adopted certain financial goals. Such goals provide a signal to NES as to the adequacy of rates for funding ongoing cash flows from operations. One such goal is a cash goal of 7% of in-lieu-of-tax payments, purchased power, and operating and maintenance expenses. Although the target has not been met for the last several fiscal years, primarily because of mild weather, a rate increase of 2.5% effective October 2005 is expected to provide an additional $20.6 million annual increase in net revenues. Management believes that such an action will provide sound funding while meeting our goals through fiscal year 2010. In addition, NES will pass through a 5.8% rate increase from TVA.

SUMMARY REVENUE & EXPENSE DATA ($000 OMITTED)

	Year Ended June 30, 2005	2004	Favorable (Unfavorable)
Operating Revenues	$785,711	$787,999	$(2,288)
Purchased Power	597,659	604,277	6,618
Margin	188,052	183,722	4,330
Operating Expenses	108,666	98,581	(10,085)
Depreciation and Taxes	55,980	53,039	(2,941)
Interest Income	5,876	1,374	4,502
Interest Expense	24,922	20,038	(4,884)
Increase in Net Assets	$ 4,360	$ 13,438	$(9,078)

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL OPERATIONS 2005 (continued)
2005 AND 2004 RESULTS OF OPERATIONS

MEGAWATT-HOURS SOLD (000 OMITTED)



Operating Revenues. Operating revenues decreased by $2.3 million, or 0.3%, when compared to 2004. Total electric sales were $770.4 million for the period versus $772.7 million last year. The average realized rate on electric sales was $.0646 per kilowatt-hour in 2005 compared to $.0635 per kilowatt-hour in 2004. Megawatt-hours sold in 2005 decreased by 2.0% when compared to 2004. Weather plays an important part in determining revenue for any year. The impact of weather is reflected in the comparison degree-days from one period to the next. Degree-days represent the difference between the weather's average daily temperature minus 65 degrees. Temperatures above 65 degrees are considered cooling degree-days; temperatures below 65 degrees are considered heating degree-days. Total heating and cooling degree-days were 4,501 in 2005 compared to 4,930 in 2004 or a decrease of approximately 9.1%. Total average number of active year-to-date customers in 2005 increased by 1.6% when compared to 2004.

The following table reflects the revenue impact of rates and weather compared to last year:

	Electric Sales ($000 Omitted)	MWH Sales (000 Omitted)	Average Rates
Fiscal 2005	$770,396	11,925	$0.0646
Fiscal 2004	772,731	12,162	0.0635
Net Change	$ (2,335)	(237)	$0.0011
Net Change Attributable to Weather	(15,059)		
Net Change Attributable to Rates and Sales Mix	12,724		
Net Change	(2,335)		

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL OPERATIONS 2005 (continued)
2005 AND 2004 RESULTS OF OPERATIONS (continued)

Non-operating Revenues. Interest Income was $5.9 million compared to $1.4 million in 2004. This increase was due to the increase in cash balances and an increase in interest rates. The average rate of return on the General Fund was 2.21% in 2005 compared to 0.99% in 2004, an increase of 123%. The average monthly balance of the General Fund was $51.4 million in 2005 compared to $43.4 million in 2004, an increase of 18.6%. Because of the 2004 bond issue, the Special Construction Fund maintained an average balance of $82.3 million, which was $64.1 million greater than the previous year. This resulted in $3.6 million more in interest income.

Operating Expenses. NES purchases all of its power from the Tennessee Valley Authority (TVA) under an all requirements contract that had an initial term of 20 years. Beginning on December 19, 1989, and on each subsequent anniversary thereafter, the contract is automatically extended for an additional year. The contract is subject to earlier termination by either party on not less than 10 years' prior written notice. Purchased power was $597.7 million for 2005 compared to $604.3 million last year. The average realized rate on purchased power was $.0485 per kilowatt-hour in 2005 compared to $.0480 per kilowatt-hour in 2004. A decrease in purchased power of $1.9 million for 2005 was the result of a billing adjustment to TVA reflecting a correction of an error for certain credits in prior years that had not been taken. The average realized rate for 2005 would have been $.0487 per kilowatt-hour if this correction were not included in the calculation. Megawatt-hours purchased were 12.3 million in 2005 compared to 12.6 million in 2004. Line losses were 2.9% in 2005 compared to 3.2% in 2004, or a decrease of 9.4%.

Distribution expense for 2005 was $45.7 million compared to $42.0 million last year. This is an increase of $3.7 million or 9.0%. The change is primarily attributable to increases in payroll of $2.3 million and tree-trimming of $1.3 million. Much of these charges were the result of more charges going to Operations and Maintenance than capital from implementation of the new work management, supply chain and accounting system.

Customer Account expense and Customer Service and Information expenses combined were $19.4 million for 2005 compared to $17.8 million last year or an increase of $1.6 million or 9.0%. This is primarily the result of an increase in the data processing costs of $0.9 million and payroll of $0.5 million.

Administrative and General expenses were $43.5 million for 2005 compared to $38.8 million last year. This was an increase of $4.7 million or 12.2%. The increase is primarily a result of an increase in employee health costs of $2.6 million; employee pensions of $1.3 million; and office supplies and expenses of $0.6 million. The employees of NES are covered by a non-contributory defined benefit pension plan. The funding requirements are determined annually by an independent actuary. NES is self-insured for medical claims. The experience this year was greater than last year due to increased medical costs and increased claims. The primary cause for the increased office supplies and expenses was due to changes in payroll and professional assistance for a strategic planning initiative.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL OPERATIONS 2005 (continued)
2005 AND 2004 RESULTS OF OPERATIONS (continued)

Depreciation and Tax equivalents were $34.0 million and $22.0 million compared to $32.1 million and $20.9 million for 2005 and 2004, respectively. The increase in depreciation was the result of increased investment in the utility plant. Tax equivalents consist primarily of payments in lieu of taxes to the Metropolitan Government and the surrounding counties. Such payments are calculated based on a prescribed formula that takes into consideration utility plant value and the average of NES' last three years' operating margin. The increase in payments in lieu of taxes was primarily the result of increased investment in the utility plant.

The following table shows the composition of the operating expenses (excluding costs of depreciation and tax equivalents) of NES by major classification of expense for the last two years:

MAJOR CLASSIFICATIONS OF EXPENSE ($000 OMITTED)

Description	Fiscal 2005	Fiscal 2004	Favorable (Unfavorable)
Labor, excluding overtime	$ 40,192	$37,226	(8.0%)
Benefits	27,290	23,292	(17.2%)
Tree-trimming	13,489	12,211	(10.5%)
Outside Services	5,944	4,695	(26.6%)
Materials	3,853	3,856	0.1%
Transportation	3,372	2,955	(14.1%)
Other	14,526	14,346	(1.3%)
	$108,666	$98,581	(10.2%)

Increases in labor and benefit costs are the primary factors for the overall increase. Benefit costs increased due to the increased cost of the medical plan and the pension plan. Contributing to the increase in labor were scheduled salary increases and increased maintenance performed during the first year using the new work management, supply chain and accounting system. Tree-trimming expenditures increased 10.5% over last year as the first three-year cycle of trimming of the distribution system was completed. Outside services increased because contract crews were used in storm restoration and pole pulling. Transportation increased because of increased fuel costs.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL OPERATIONS 2005 (continued)
2005 AND 2004 RESULTS OF OPERATIONS (continued)

BUDGETARY HIGHLIGHTS

NES approves an operating and capital budget each fiscal year. The budget remains in effect the entire year and is not revised.

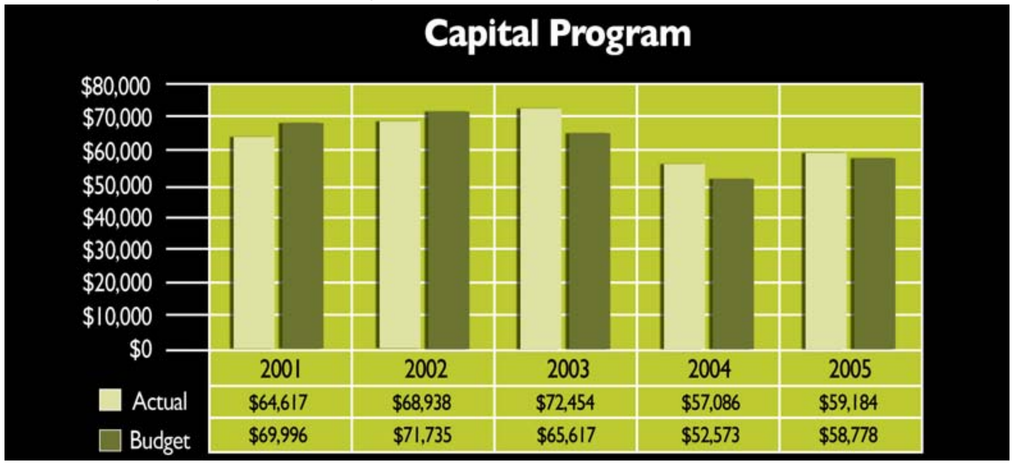
	Year Ended June 30, 2005 ($000 omitted)		Favorable
	Budget	Actual	(Unfavorable)
Operating Revenues	$811,806	$785,711	$(26,095)
Purchased Power	622,468	597,659	24,809
Margin	189,338	180,052	(1,286)
Operating Expenses	105,530	108,666	(3,136)
Depreciation and Taxes	55,715	55,980	(265)
Interest Income	5,247	5,876	629
Interest Expense	24,732	24,922	(190)
Increase in Net Assets	$ 8,608	$ 4,360	$ (4,248)
Capital Expenditures	$ 58,778	$ 59,184	$ (406)

NES' increase in net assets was $4.2 million under its target of $8.6 million. The lack of margin was a major contributor to the decrease in net assets. Degree-days were only 87% of normal. Even with the growth in customers of 1.6%, the total kilowatt-hours sold were 2.0% below last year. The contributors to the variance in operating expenses were medical of $2.0 million, tree-trimming of $1.1 million, and outside services of $1.1 million over budget. The increase in outside services was the result of contract crews for storms and pole pulling.

The 2005 Capital Budget was $58.8 million; $59.2 million was spent. This budget variance is primarily associated with the following categories: Actual expenditures for new business were $3.0 million and for renewals and replacements were $1.3 million over budget. This was offset by a decrease in the purchase of meters and transformers of $2.9 million.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL OPERATIONS 2005 (continued)
2005 AND 2004 RESULTS OF OPERATIONS (continued)

CAPITAL PROGRAM ($000 OMITTED)



CAPITAL ASSETS AND DEBT ADMINISTRATION

NES' transmission and distribution facilities serve all of the 533 square miles located within the boundaries of the Metropolitan Government of Nashville and Davidson County, Tennessee. NES serves an additional 167 square miles located in minor portions of the adjacent counties of Cheatham, Robertson, Rutherford, Sumner, Williamson and Wilson. Such facilities require significant annual capital and maintenance expenditures. NES' target is to have the capital expenditures funded equally from cash flow from operations and proceeds from tax-exempt bonds. NES' investment in utility plant at June 30, 2005, was $674.7 million compared to $654.6 million at June 30, 2004. Major projects during fiscal year 2005 included $2.4 million in breaker replacement, $1.0 million in the Old Smyrna Road substation, and $1.4 million in the Southwest substation property purchase. The remainder consists of numerous smaller projects.

NES has outstanding bonds payable of $466.8 million at June 30, 2005, compared to $478.7 million at June 30, 2004; the decrease is due to the scheduled principal payments on the bonds.

NES' financing cost may be impacted by short-term and long-term debt ratings assigned by independent rating agencies, which are based, in significant part, on NES' performance as measured by certain credit measures such as the aforementioned cash targets and debt coverage ratios. NES' debt coverage ratio for the 12 months ended June 2005 was 2.3 to 1. NES continues to exceed its goal of 2 to 1. NES' revenue bonds are rated Aa, AA, and AA by Moody's, Standard & Poor's, and Fitch, respectively. The outlook on all ratings is stable.

Respectfully submitted,

Dick Sittel
Vice President and Chief Financial Officer

ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

STATEMENTS OF NET ASSETS ($000 OMITTED)
JUNE 30, 2005 AND 2004

	2005	2004
ASSETS		
CURRENT ASSETS:		
Cash and short-term investments	$ 40,688	$ 47,738
Customer and other accounts receivable, less allowance for doubtful accounts of $407 and $416, respectively	83,773	83,138
Accrued interest receivable	1,941	92
Materials and supplies	11,957	10,452
Other current assets	1,621	1,406
TOTAL CURRENT ASSETS	139,980	142,826
INVESTMENT OF RESTRICTED FUNDS:		
Cash and cash equivalents	9,069	98,586
Other investments	109,096	41,754
TOTAL RESTRICTED FUNDS	118,165	140,340
UTILITY PLANT:		
Electric plant, at cost	1,052,427	1,008,713
Less accumulated depreciation	(377,699)	(354,078)
TOTAL UTILITY PLANT, NET	674,728	654,635
ENERGY CONSERVATION PROGRAMS' NOTES RECEIVABLE	1,646	2,377
UNAMORTIZED BOND ISSUANCE COST	2,839	3,036
OTHER NONCURRENT ASSETS	393	488
TOTAL ASSETS	$937,751	$943,702

See notes to financial statements.

ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

LIABILITIES AND NET ASSETS ($000 OMITTED)
JUNE 30, 2005 AND 2004

	2005	2004
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES PAYABLE FROM NON-RESTRICTED ASSETS:		
Accounts payable for purchased power	$ 77,756	$ 82,415
Other accounts payable and accrued expenses	16,468	11,300
Customer deposits	9,879	8,425
TOTAL CURRENT LIABILITIES PAYABLE FROM NON-RESTRICTED ASSETS	104,103	102,140
CURRENT LIABILITIES PAYABLE FROM RESTRICTED ASSETS:		
Construction contracts payable	1,628	1,366
Accrued interest payable	2,177	2,296
Current portion of long-term debt	12,940	17,485
TOTAL CURRENT LIABILITIES PAYABLE FROM RESTRICTED ASSETS	16,745	21,147
LONG-TERM DEBT	453,853	461,245
OTHER NONCURRENT LIABILITIES:		
Payable to TVA — energy conservation programs	1,646	2,377
Other	1,113	862
TOTAL OTHER NONCURRENT LIABILITIES	2,759	3,239
COMMITMENTS AND CONTINGENCIES		
NET ASSETS:		
Invested in capital assets, net of related debt	282,415	274,529
Restricted for debt payment	42,719	41,089
Unrestricted	35,157	40,313
	360,291	355,931
TOTAL LIABILITIES AND NET ASSETS	$937,751	$943,702

See notes to financial statements.

ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS ($000 OMITTED)
YEARS ENDED JUNE 30, 2005 AND 2004

	2005	2004
OPERATING REVENUES:		
Residential	$308,782	$313,025
Commercial and industrial	449,286	447,496
Street and highway lighting	12,328	12,210
Other	15,315	15,268
Total operating revenues	785,711	787,999
PURCHASED POWER	597,659	604,277
MARGIN	188,052	183,722
OPERATING EXPENSES:		
Distribution	45,714	41,953
Customer accounts	18,425	17,091
Customer service and information	978	727
General and administrative	43,549	38,810
Tax equivalents	21,993	20,929
Depreciation	33,987	32,110
Total operating expenses	164,646	151,620
Operating income	23,406	32,102
NON-OPERATING REVENUE (EXPENSE):		
Interest income	5,876	1,374
Interest expense	(24,922)	(20,038)
Total non-operating revenue (expense)	(19,046)	(18,664)
NET INCREASE IN NET ASSETS	4,360	13,438
NET ASSETS, Beginning of Year	355,931	342,493
NET ASSETS, End of Year	$360,291	$355,931

See notes to financial statements.

ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

STATEMENTS OF CASH FLOWS ($000 OMITTED)
YEARS ENDED JUNE 30, 2005 AND 2004

	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from customers	$789,331	$780,874
Payments to suppliers for goods and services	(669,537)	(655,627)
Payments to employees	(40,543)	(37,467)
Payments for tax equivalents	(21,642)	(20,623)
Net cash provided by operating activities	57,609	67,157
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Acquisition and construction of utility plant	(49,973)	(50,594)
Utility plant removal costs	(4,554)	(3,791)
Salvage received from utility plant retirements	447	587
Principal payments on revenue bonds	(17,485)	(16,590)
Proceeds from sale of revenue bonds	–	109,193
Interest paid on revenue bonds	(19,296)	(15,132)
Net cash (used in) provided by capital and related financing activities	(90,861)	23,673
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investment securities	(311,194)	(403,044)
Proceeds from sale and maturities of investment securities	333,369	329,719
Interest on investments	4,027	2,243
Net cash provided by (used in) investing activities	26,202	(71,082)
NET (DECREASE) INCREASE IN CASH AND SHORT-TERM INVESTMENTS - UNRESTRICTED	(7,050)	19,748
CASH AND SHORT-TERM INVESTMENTS AT BEGINNING OF YEAR - UNRESTRICTED	47,738	27,990
CASH AND SHORT-TERM INVESTMENTS AT END OF YEAR - UNRESTRICTED	$ 40,688	$ 47,738

See notes to financial statements.

ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

STATEMENTS OF CASH FLOWS ($000 OMITTED)
YEARS ENDED JUNE 30, 2005 AND 2004 (continued)

	2005	2004
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	$23,406	$32,102
ADJUSTMENTS TO RECONCILE NET OPERATING REVENUES TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Depreciation	33,987	32,110
Changes in assets and liabilities:		
Increase in customer and other accounts receivable	(635)	(9,139)
(Increase) decrease in materials and supplies	(1,505)	167
Increase in other current assets	(215)	(143)
Decrease in energy conservation programs' notes receivable	731	592
Decrease (increase) in other noncurrent assets	95	(173)
(Decrease) increase in accounts payable for purchased power	(4,659)	16,231
Increase (decrease) in other accounts payable, accrued expenses and construction contracts payable	5,430	(4,972)
Increase in customer deposits	1,454	1,422
Decrease in payable to TVA – energy conservation programs	(731)	(563)
Increase (decrease) in other noncurrent liabilities	251	(477)
Net cash provided by operating activities	$57,609	$67,157

NONCASH CAPITAL AND RELATED FINANCING ACTIVITIES:

During 2005 and 2004, NES charged $8.3 million and $12.8 million, respectively, to accumulated depreciation representing the cost of retired utility plant.

During 2005 and 2004, ($155) thousand and ($114) thousand, respectively, were charged to interest expense for amortization of bond premiums. Also, $681 thousand and $640 thousand were charged as amortization of the bond-issuance costs in 2005 and 2004, respectively.

See notes to financial statements.

ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Electric Power Board of the Metropolitan Government of Nashville and Davidson County (the "Board") was established in 1939 when the City of Nashville purchased certain properties of the Tennessee Electric Power Company for the purpose of exercising control and jurisdiction over the electric distribution system. In conducting the operations of the electric distribution system the Board does business as Nashville Electric Service ("NES"). NES is a component unit of the Metropolitan Government of Nashville and Davidson County, Tennessee (the "Metropolitan Government"), and operated by a five-member board appointed by the Mayor and confirmed by the Council. Members of NES serve five-year staggered terms without pay. In accordance with the Charter of the Metropolitan Government, NES exercises exclusive control and management, except NES must obtain the approval of the Council before issuing revenue bonds. NES appoints a chief executive officer. The chief executive officer is charged with the responsibility for the day-to-day operations, including hiring of employees.

The financial statements of NES have been prepared in conformity with accounting principles generally accepted in the United States of America. NES maintains its accounts in accordance with the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission on the accrual basis of accounting. NES is not subject to the jurisdiction of federal or state regulatory commissions.

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*, NES has elected to apply Financial Accounting Standards Board ("FASB") Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements.

The significant accounting policies followed by NES are outlined below.

Estimates used in the preparation of financial statements require management to make assumptions that affect the reported amounts of assets and liabilities, 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.

For Purposes of the Statements of Cash Flows, cash and cash equivalents include unrestricted cash, commercial paper, U.S. Treasury Bills and certificates of deposit with an original maturity of three months or less.

Restricted Assets of NES represent bond proceeds designated for construction and other monies required to be restricted for debt service.

Utility Plant is stated at original cost. Such cost includes applicable general and administrative costs and payroll and related costs such as pensions, taxes and other fringe benefits related to plant construction. Interest cost incurred during the period of construction of certain plant is capitalized. Capitalized interest was $578 thousand and $779 thousand in 2005 and 2004, respectively. Costs of depreciable retired utility plant, plus removal costs, less salvage, are charged to accumulated depreciation.

ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Depreciation is provided at rates which are designed to amortize the cost of depreciable plant over the estimated useful lives ranging from five to 50 years. The composite straight-line rates expressed as a percentage of average depreciable plant were as follows for June 30, 2005 and 2004:

	2005	2004
Distribution plant, 18.2 to 40 years	3.2%	3.3%
Structures and improvements, 40 to 50 years	2.0%	2.0%
Office furniture and equipment, 7.1 to 16.7 years	14.6%	13.4%
Transportation equipment, 8 to 10 years	7.3%	8.0%
Other equipment, 8 to 33.3 years	7.5%	7.6%

Maintenance and repairs, including the cost of renewals of minor items of property, are charged to either maintenance expense accounts or utility plant accounts. Replacements of property are charged to utility plant accounts.

Investments and Cash Equivalents (including restricted assets) consist primarily of short-term U.S. Government or mortgage-backed securities from agencies chartered by Congress and certificates of deposit. In accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools*, investments are reflected at their fair value except those investments that have a remaining maturity at the time of purchase of one year or less and certificates of deposit, which are reflected at cost.

Materials and Supplies are stated at the moving weighted average cost.

Arbitrage Rebate Payable, which is included in other accounts payable and accruals, represents estimated amounts payable to the federal government for interest earnings on bond proceeds in excess of amounts allowed under federal regulations.

Unamortized Bond Issuance costs incurred in connection with the issuance of bonds are being amortized over the respective lives of the bond issues using the effective interest method.

Compensated Absences represent the liability for employees' accumulated vacation days. The general policy of NES permits the accumulation, within certain limitations, of unused vacation days.

Revenues are recognized from meters read on a monthly cycle basis. Service that has been rendered from the latest date of each meter-reading cycle to month end is accrued as unbilled revenue receivable.

NES purchases electric power from the Tennessee Valley Authority ("TVA"). The cost of purchased power is calculated based upon retail billing units adjusted for estimated line losses. NES accrues for unbilled purchased power based on retail billing units.

ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Asset Retirement Obligations are periodically reviewed in accordance with SFAS No. 143, *Accounting for Asset Retirement Obligations,* and management has concluded that at present NES does not have any such asset retirement obligations.

Operating and Non-operating Revenues and Expenses – Operating revenues include the sale of power and rental of electric property. Operating expenses include direct and indirect costs to operate and maintain the electric distribution system including purchased power, fuel, depreciation, customer accounts, tax equivalents and general and administrative costs. Non-operating revenues and expenses consist of interest income and expense.

Income Taxes – NES is not subject to federal or state income taxes.

2. UTILITY PLANT AND ACCUMULATED DEPRECIATION

Utility plant activity for the years ended June 30, 2005 and 2004, was as follows ($000 omitted):

	Balance June 30, 2004	Additions	Transfers & Retirements	Balance June 30, 2005
Distribution plant	$ 853,870	$36,060	$(5,046)	$ 884,884
Land and land rights	1,139	-	-	1,139
Structures and improvements	36,822	1,677	-	38,499
Office furniture and equipment	24,385	14,137	(1,451)	37,071
Transportation equipment	5,705	567	(346)	5,926
Other equipment	35,435	763	(1,417)	34,781
Construction work-in-progress (a)	51,357	(1,230)	-	50,127
	$1,008,713	$51,974	$(8,260)	$1,052,427

	Balance June 30, 2003	Additions	Transfers & Retirements	Balance June 30, 2004
Distribution plant	$808,936	$52,625	$(7,691)	$ 853,870
Land and land rights	1,139	-	-	1,139
Structures and improvements	33,634	3,188	-	36,822
Office furniture and equipment	23,991	604	(210)	24,385
Transportation equipment	6,613	525	(1,433)	5,705
Other equipment	37,421	1,510	(3,496)	35,435
Construction work-in-progress (a)	57,017	(5,660)	-	51,357
	$968,751	$52,792	$(12,830)	$1,008,713

(a) Represents the net activity to the construction work-in-progress account after transfers to plant accounts.

ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

2. UTILITY PLANT AND ACCUMULATED DEPRECIATION (continued)

The related activity for accumulated depreciation for the years ended June 30, 2005 and 2004, was as follows ($000 omitted):

	Balance June 30, 2004	Provision	Original Cost of Retirement	Cost of Removal	Salvage	Balance June 30, 2005
Distribution plant	$310,216	$27,687	$(5,046)	$(4,554)	$323	$328,626
Structures and improvements	10,906	752	-	-	-	11,658
Office furniture and equipment	16,751	4,496	(1,452)	-	6	19,801
Transportation equipment	580	426	(345)	-	71	732
Other equipment	15,625	2,627	(1,417)	-	47	16,882
	$354,078	$35,988	$(8,260)	$(4,554)	$447	$377,699

	Balance June 30, 2003	Provision	Original Cost	Cost of Removal	Salvage	Balance June 30, 2004
Distribution plant	$294,216	$27,101	$(7,689)	($3,791)	$379	$310,216
Structures and improvements	10,197	709	-	-	-	10,906
Office furniture and equipment	13,708	3,246	(210)	-	7	16,751
Transportation equipment	1,397	490	(1,434)	-	127	580
Other equipment	16,286	2,761	(3,496)	-	74	15,625
	$335,804	$34,307	$(12,829)	$(3,791)	$587	$354,078

ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

3. CASH AND INVESTMENTS

Cash and investments consist of the following ($000 omitted):

2005

	Cash & Short-term Investments	Bond Funds	Special Construction	Total	Weighted Average Maturity (Years)
Cash and Cash Equivalents	$ 16	$ 614	$ 8,455	$ 9,085	-
U.S. Treasury Investments	-	44,282	-	44,282	0.96
Mortgage-backed Securities from Agencies Chartered by Congress	-	-	64,814	64,814	1.11
Other Investments	40,672	-	-	40,672	0.04
	$40,688	$44,896	$73,269	$158,853	0.78

2004

	Cash & Short-term Investments	Bond Funds	Special Construction	Total	Weighted Average Maturity (Years)
Cash and Cash Equivalents	$ 1,214	$ 1,631	$96,955	$ 99,800	-
U.S. Treasury Investments	-	41,754	-	41,754	1.75
Other Investments	46,524	-	-	46,524	0.04
	$47,738	$43,385	$96,955	$188,078	0.02

ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

3. CASH AND INVESTMENTS (continued)

Investments of $88.8 million and $36.3 million at June 30, 2005 and 2004, respectively, in U.S. Treasury investments are reported at fair value, and investments of $69.6 million and $52.0 million at June 30, 2005 and 2004, respectively, in U.S. Treasury investments, commercial paper and certificates of deposit are reported at cost.

The net increase in the fair value of investments during fiscal year 2005 was $1.2 million. This amount takes into account all changes in fair value (including purchases and sales) that occurred during the year. The unrealized gain on investments held at year-end was $1.3 million, which is recorded in interest income.

Custodial Credit Risk – As of June 30, 2005 and 2004, NES' cash held by financial institutions was $442 thousand and $99.8 million, respectively. Bank balances for such accounts totaled $3.9 million and $103.1 million, respectively. Deposits in financial institutions are required by State of Tennessee ("State") statute to be secured and collateralized by the institutions. The collateral must meet certain requirements and have a total minimum market value of 105% of the value of the deposits placed in the institutions less the amount protected by federal depository insurance. Collateral requirements are not applicable for financial institutions that participate in the State's collateral pool. As of June 30, 2005 and 2004, all of NES' deposits were held by financial institutions which participate in the bank collateral pool administered by the State Treasurer. Participating banks determine the aggregated balance of their public-fund accounts for the Metropolitan Government. The amount of collateral required to secure these public deposits is a certain percentage set by the State, depending on the financial institution, and must be at least that percentage of the average daily balance of public deposits held. Collected securities required to be pledged by the participating banks to protect their public-fund accounts are pledged to the State Treasurer on behalf of the bank collateral pool. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement, public-fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure.

Credit Risk – NES is authorized to invest in obligations of the U.S. Treasury and U.S. governmental agencies, mortgage-backed securities from agencies chartered by Congress, certificates of deposit, commercial paper rated A1 or equivalent and bonds of the State of Tennessee. Each of these investments is insured, registered or held by NES or its agent in NES' name.

Concentration of Credit Risk – NES places no limit on the amount it may invest in any one issuer. More than 5% of NES' investments are in Freddie Mac, U.S. Treasury investments and a Public Fund Trust. These investments are 43.3%, 29.6% and 26.8%, respectively, of NES' total investments.

Interest Rate Risk – NES does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increase in interest rates.

ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

4. LONG-TERM DEBT

Long-term debt for the year ended June 30, 2005, is as follows ($000 omitted):

	Balance June 30, 2004	Deductions/ Repayments	Additions/ Amortization/ Accretion	Balance June 30, 2005
Electric System Revenue Bonds, 1992 Series B, bear interest at rates from 4.25% to 5.62%, maturing through May 15, 2005, interest paid semi-annually.	$ 15,683	$(15,735)	$ 52	$ -
Electric System Revenue Bonds, 1996 Series A, bear interest at rates from 5.50% to 6.00%, maturing through May 15, 2013, interest paid semi-annually.	74,000	-	4,344	78,344
Electric System Revenue Bonds, 1998 Series A, bear interest at rates from 5.125% to 5.40%, maturing through May 15, 2023, interest paid semi-annually.	90,295	-	977	91,272
Electric System Revenue Bonds, 1998 Series B, bear interest at rates from 3.80% to 5.50%, maturing through May 15, 2017, interest paid semi-annually.	57,236	(185)	201	57,252
Electric System Revenue Bonds, 2001 Series A, bear interest at rates from 4.50% to 5.00%, maturing through May 15, 2017, interest paid semi-annually.	113,567	(1,565)	(36)	111,966
Electric System Revenue Bonds, 2001 Series B, bear interest at 5.50%, maturing through May 15, 2014, interest paid semi-annually.	18,588	-	7	18,595
Electric System Revenue Bonds, 2004 Series A, bear interest at rates from 4.50% to 5.00%, maturing through May 15, 2029, interest paid semi-annually.	109,361	-	3	109,364
	478,730	(17,485)	5,548	466,793
Less current portion of long-term debt	(17,485)			(12,940)
	$461,245			$453,853

ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

4. LONG-TERM DEBT (continued)

NES issues Revenue Bonds to provide funds primarily for capital improvements and for refundings of other bonds. All bond issues are secured by a pledge and lien on the net revenues of NES on parity with the pledge established by all bonds issued. Annual maturities on all long-term debt and related interest are as follows for each of the next five fiscal years and in five-year increments thereafter ($000 omitted):

	Principal	Interest
2006	$ 12,720	$ 24,347
2007	12,504	24,582
2008	12,323	24,786
2009	12,182	24,946
2010	12,102	25,049
2011-2015	115,453	70,876
2016-2020	104,129	78,856
2021-2025	122,889	34,239
2026-2029	62,491	7,536
Total	$466,793	$315,217

In March 2001, NES issued $18.4 million (original issue at a premium) of Electric System Revenue Refunding Bonds, 2001 Series B Bonds, to provide funds which were used to purchase and deposit in an irrevocable trust with an escrow agent certain U.S. government securities, the principal of and interest on which, when due, will provide funds sufficient to pay all principal and interest on a portion of 1996 Series A Bonds at their respective maturity dates. As a result of this advance refunding, the liability for a portion of 1996 Series A Bonds has been removed from the accounts of NES. As of June 30, 2005, certain of the 1996 Series A Bonds are considered defeased. This advance refunding resulted in a deferred loss of $1.5 million for the year ended June 30, 2001. In accordance with GASB Statement No. 23, *Accounting and Financial Reporting for Refunded Debt Reported by Proprietary Activities*, the loss is reported in the accompanying financial statements as a deduction from long-term debt and is being charged to operations through the year 2014 using the effective interest method. NES completed the advance refunding to reduce its total debt-service payments over the next 13 years by $1.1 million and to obtain an economic gain of $697 thousand. The following bond issues have been defeased through advance refundings; therefore, the balances indicated, which are still outstanding at June 30, 2005, do not appear as liabilities on NES' balance sheet:

ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

4. LONG-TERM DEBT (continued)

	Amounts Outstanding ($000 omitted)
Series L through N Electric Power Revenue Bonds	$ 4,490
1996 Series A Bonds	18,835

NES' ongoing sources of liquidity are operating cash flow and proceeds from tax-exempt bonds. On June 30, 2004, NES closed on the sale of the Metropolitan Government of Nashville and Davidson County, Tennessee, Electric System Revenue Bonds, 2004 Series A. The purpose of the 2004 Series A Bonds was to reimburse NES for a portion of the 2004 capital expenditures and to fund approximately 50% of NES' projected $181 million capital budget for the fiscal years ending June 30, 2005, through June 30, 2007. The remainder will be funded with operating revenues. The par amount of the 2004 Series A Bonds, $110 million, less original issue discount, underwriter discount, cost of issuance, and a deposit to the debt service reserve fund, netted proceeds in the amount $106.9 million, of which $96.9 million was deposited into the special construction fund and $10 million went to the general fund to reimburse the fund for capital expenditures for fiscal 2004. The proceeds will be drawn down quarterly over the next two years.

NES has a $25 million unsecured line of credit to be used for general operating purposes in the event of a natural catastrophe. Borrowings under this line of credit bear a negotiated interest rate. At June 30, 2005 and 2004, there we no borrowings outstanding under this line of credit.

5. OTHER NONCURRENT LIABILITIES

NES' other noncurrent liabilities consist primarily of TVA energy conservation program loans. The following table shows the activity for the year ($000 omitted):

	June 30, 2004	Repayments	Additions	June 30, 2005
Other noncurrent liabilities	$3,239	$(1,986)	$1,506	$2,759

NES is a fiscal intermediary for the TVA energy conservation programs whereby loans are made to NES' customers to be used in connection with TVA's Residential Energy Services Program. Pursuant to the terms of an agreement with TVA, the energy conservation loans made to NES' customers are funded and guaranteed by TVA.

ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

6. PENSION PLAN

The Nashville Electric Service Retirement Annuity and Survivors' Benefit Plan (the "Plan") is a single employer defined benefit pension plan administered by NES. The Plan provides retirement and survivors' benefits to members and beneficiaries. Cost-of-living adjustments are provided to members and beneficiaries at the discretion of NES. The Charter of the Metropolitan Government assigns the authority to establish and amend benefit provisions to NES. The Plan does not issue a separate, standalone financial report.

All full-time regular employees under age 65 are eligible to participate in the Plan. The vesting provision of the Plan provides for five-year cliff vesting. NES employees who retire at or after age 65 are entitled to annual retirement benefits payable monthly for life in an amount equal to 2% of final average compensation multiplied by years in the Plan not in excess of 35 years. Final average compensation is the average compensation in the 36 consecutive months in which compensation is highest. Unused sick leave may be used to increase credited service and benefit percentage under certain circumstances. Early retirement is an option beginning at age 55 with 15 years of credited service or at age 50 with 30 years of credited service with an actuarially reduced monthly benefit.

The contribution requirements of NES are established and may be amended by NES. The Plan is currently non-contributory. NES' policy is to fund at least the minimum contribution for a 30-year funding level. The current rate is 23.6% of annual covered payroll. NES contributed 100 percent of the required contribution for the Plan years 2005, 2004, and 2003.

The annual required contribution for the current year was determined as part of the April 1, 2004, actuarial valuation using the frozen initial liability method. The actuarial assumptions included (a) 8% investment rate of return and (b) projected salary increases of 4.5%. Both (a) and (b) included an inflation component. The assumptions include cost-of-living post-retirement benefit increases equal to 2% per year. The actuarial value of Plan assets is determined using techniques that smooth the effects of short-term volatility in the market value of investments over a three-year period. The unfunded actuarial accrual liability is being amortized over 30 years.

Schedule of employer contributions for the past three years is shown below ($000 omitted):

Plan Year	Annual Required Contribution	Percentage Contributed
2005	$12,719	100%
2004	$11,652	100%
2003	$ 9,675	100%

ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

6. PENSION PLAN (continued)

Schedule of funding progress for the past three years is shown below ($000 omitted):

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL) Entry Age	Actuarial Unfunded Accrued Liability (AUAL)	Funded Ratio	Covered Payroll	Unfunded Actuarial Accrued Liability as a Percent of Covered Payroll
	(a)	(b)	(b-a)	(a/b)	(c)	(b-a)/c
4/1/2005	$223,611	$273,464	$49,853	0.82	$54,008	92.31%
4/1/2004	205,139	256,149	51,010	0.80	51,616	98.83%
4/1/2003	188,718	240,639	51,921	0.78	50,143	103.55%

In 1994, NES established a non-qualified Supplemental Executive Retirement Plan (the "SERP"), which was limited to certain employees of NES. Benefits accrued at the rate of 5% of salary for each year of credited service not to exceed 12 years and vests at the rate of 20% for each year of service, reduced by the percentage accrued and vested under NES' qualified plan. Effective April 1, 2005, the Board merged the SERP with the NES Retirement Annuity and Survivor's Benefit Plan. Adding the SERP benefits to the Plan increased the funding requirements for the Plan, but the amounts that had accumulated in the SERP Trust were transferred to the Plan in order to offset those increased costs. Future payments that would have been made into the SERP Trust will be directed into the Plan. At the time of conversion, no benefits had been paid from the SERP. Any change in funding requirements is reflected in the above schedule.

ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

7. DEFERRED COMPENSATION PLAN

NES has a deferred compensation plan (the "Plan") created in accordance with Internal Revenue Code ("IRC") Section 457. The Plan, available to all full-time employees, permits employees to defer a portion of their salary until future years. Employees may contribute up to the legal limit of their compensation to the Plan with NES providing a matching contribution of up to 3% of compensation. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency. The Plan provides that assets or income of the Plan shall be used for the exclusive purpose of providing benefits for participants and their beneficiaries or defraying reasonable expenses of administration of the Plan. Since the assets of the Plan are held in custodial and annuity accounts for the exclusive benefit of Plan participants, the related assets of the Plan are not reflected on the balance sheet. Employees contributed $2.8 million and $2.6 million and NES contributed $1.4 million and $1.3 million to the Plan during the years ended June 30, 2005 and 2004, respectively.

8. POST-EMPLOYMENT BENEFITS

In addition to the pension benefits described in Note 6 and Note 7, NES provides post-retirement health care benefits to all employees who retire from NES under the provisions of the qualified plan and supplemental executive retirement plan. Currently, 472 retirees meet those eligibility requirements. Expenses for post-retirement health care benefits are recognized as retirees report claims. Expenses of $7.3 million and $6.3 million for the years ended June 30, 2005 and 2004, respectively, were recognized for post-retirement health care.

The GASB has issued Statement No. 45 titled *Accounting and Financial Reporting by Employers for Post-employment Benefits Other than Pensions*. GASB Statement No. 45 requires the accrual of liabilities of other post-employment benefits (OPEB) generally over the working careers of plan members rather than on a pay-as-you-go basis which is the current practice. NES will have to comply with GASB Statement No. 45 for the fiscal year ending June 30, 2008. NES does not intend to early adopt this pronouncement.

To assess the magnitude of this requirement, NES commissioned a valuation report as of January 1, 2005, covering medical, dental and life insurance. The purpose of the valuation was to determine the Annual Required Contribution (ARC) under selected actuarial cost methods and amortization methods as prescribed by GASB Statement No. 45. These ARC estimates varied from $19.1 million to $28.5 million based on various assumptions. Projected payouts of $8.2 million resulted in net costs of between $10.9 million and $20.3 million. The unfunded accrued liability is estimated at between $293.4 million and $303.7 million.

This is being furnished for information purposes only. The fiscal 2008 financial statements will comply with the required reporting at that time.

**ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT
OF NASHVILLE AND DAVIDSON COUNTY**

9. LEASES

Total rental expense entering into the determination of net operating revenues amounted to approximately $939 thousand and $857 thousand in 2005 and 2004, respectively. Rental expense consists primarily of payments for facilities rental and leasing arrangements for software licensing. NES leases these facilities and software under various cancelable lease agreements. Rental income is received under pole-attachment leases, which are accounted for as operating leases. These leases are cancelable. Therefore, future minimum rentals under these leases are not significant. Rental income from this source totaled $2.0 million and $1.7 million for the years ended June 30, 2005 and 2004, respectively.

10. RISK MANAGEMENT AND LIABILITY

NES is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. NES is an agency of the Metropolitan Government and is covered under the Tennessee Governmental Tort Liability Act, TCA 29-20-101, et al, (the "Act") and is self-insured under the Act for tort liability. NES is immune from any award or judgment for death, bodily injury and/or property damage in excess of the limits as set fourth in the Act; therefore, NES has not secured insurance coverage in excess of such limits. NES is a participant in the Metropolitan Government Insurance Pool (the "Pool") for coverage of all property losses. The Pool is currently operated as a common risk management and insurance program for several public entities including NES, the Metropolitan Nashville Airport Authority, the Metropolitan Transit Authority and the Department of Water and Sewerage Services. The Pool is self-sustaining through member premiums. NES subrogates for all losses paid out for the negligence of other parties. NES is self-insured for employee dental claims and self-insured up to $350,000 per individual per year for medical and prescription claims. The changes in the insurance reserves for medical and dental benefits for the years ended June 30, 2005 and 2004, are as follows ($000 omitted):

Balance — June 30, 2003	$ 1,060
Payments	(16,582)
Incurred Claims	16,958
Balance — June 30, 2004	$ 1,436
Payments	(16,630)
Incurred Claims	16,954
Balance — June 30, 2005	$ 1,760

NES continues to carry commercial insurance for all other risks of loss, including a retention with excess workers' compensation coverage and employee health and accident insurance. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past two fiscal years.

ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

11. COMMITMENTS AND CONTINGENCIES

In October of 2004, NES entered into an agreement with an outside firm, whereby the firm provides professional services for the management, operation and support of NES' information and data processing system. The agreement has an initial term of three years and may be renewed for two additional one-year periods. In November of 2004, NES entered into an agreement with an outside firm, whereby the firm provides computer hardware services operation for NES' mainframe information system. The new agreement has an initial term of three years and may be renewed for two additional one-year periods. The minimum commitments remaining under these agreements are: $4.9 million (2006), $4.9 million (2007) and $1.5 million (2008).

NES is party to various lawsuits filed against it in the normal course of business. Management does not believe that damages, if any, arising from outstanding litigation, will have a material effect on the financial position of NES.

12. RELATED PARTY TRANSACTIONS

NES had related party balances and transactions as a result of providing electric power to the Metropolitan Government and entities of the Metropolitan Government, as well as making tax-equivalent payments to the Metropolitan Government and other payments to entities of the Metropolitan Government. These balances and transactions as of and for the years ended June 30, 2005 and 2004, are summarized as follows ($000 omitted):

	2005	2004
Balances:		
Accounts receivable	$ 1,408	$ 1,522
Accounts payable	96	68
Transactions:		
Street and highway lighting revenue—Metropolitan Government	4,445	4,374
Commercial and industrial revenue—Metropolitan Government entities	36,011	34,247
Tax equivalents—Metropolitan Government	20,535	19,526

ELECTRIC POWER BOARD OF THE METROPOLITAN GOVERNMENT OF NASHVILLE AND DAVIDSON COUNTY

13. FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair Value of Financial Instruments has been determined by NES using available market information. However, judgment is required in interpreting market data to develop the estimates of fair value. Accordingly, the fair values are not necessarily indicative of the amounts that NES could realize in a current market exchange. The carrying amounts of cash and short-term investments, investment of special funds, accounts receivable and accounts payable are a reasonable estimate of their fair value. The fair value of NES' long-term debt is estimated based on the quoted market prices for the same or similar issues. The fair value of NES' long-term debt is estimated to be $510 million and $502 million at June 30, 2005 and 2004, respectively.