



Report of Independent Auditors

Board of Trustees
Retirement System for General Employees of the
Utility Board of the City of Key West
Key West, Florida

We have audited the accompanying statements of plan net assets of the Retirement System for General Employees of the Utility Board of the City of Key West (Plan) as of December 31, 2004 and 2003, and the related statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of the Plan's board of trustees and officers. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, information regarding the Retirement System for General Employees of the Utility Board of the City of Key West's plan net assets as of December 31, 2004 and 2003 and the changes therein for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 4, 2005 on our consideration of the Plan's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's discussion and analysis and the required supplementary information listed on 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. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The introductory section, other supplementary information, investment section, actuarial section and statistical section listed on the accompanying table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. The other supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects to the basic financial statements taken as a whole. The introductory section, investment section, actuarial section and statistical section have not been subjected to the auditing procedures applied to the audit of the basic financial statements and, accordingly, we express no opinion on them.

Cherry, Bekant & Holland, L.L.P.

West Palm Beach, Florida
March 4, 2005

Retirement System for General Employees of the

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Management's Discussion and Analysis

As management of the Retirement System for General Employees of the Utility Board of the City of Key West (the "Plan"), we offer readers of the Plan's financial statements this narrative overview of the financial activities of the Plan for the years ended December 31, 2004 and 2003. This narrative is intended to supplement the Plan's financial statements, and we encourage readers to consider the information presented here in conjunction with these statements.

Overview of the financial statements

The following discussion and analysis is intended to serve as an introduction to the Plan's financial statements.

The financial statements, which are included in this report, contain:

- Statements of Plan Net Assets
- Statements of Changes in Plan Net Assets
- Notes to the Financial Statements

The report contains the following Required Supplementary Information to the financial statements:

- Schedule of Funding Progress
- Schedule of Employer Contributions
- Notes to the Required Supplementary Information

In addition, Other Supplementary Information is included to provide additional analysis of selected account groups.

The financial statements contained in the report are described below:

The Statements of Plan Net Assets is a point-in-time snapshot of account balances at fiscal year-end. It reports the assets available for future payments to retirees and any current liabilities that are owed as of the statement date. The resulting Net Assets value (Assets – Liabilities = Net Assets) represents the value of assets held in trust for pension benefits.

The Statements of Changes in Net Assets displays the effect of pension fund transactions that occurred during the fiscal year, where Additions – Deductions = Net Increase (Decrease) in Net Assets. This Net Increase (Decrease) in Net Assets reflects the change in the net asset value of the Statement of Plan Net Assets from the prior year to the current year. Both statements are in compliance with Governmental Accounting Standards Board (GASB) Pronouncements.

The Notes to the Financial Statements are an integral part of the financial statements and provide additional information that is essential to the comprehensive understanding of the data provided in the financial statements. These notes describe the accounting and administrative policies under which the Plan operates and provide additional levels of detail for select financial statement items.

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Because of the long-term nature of a defined benefit pension plan, financial statements alone cannot provide sufficient information to properly reflect the ongoing plan perspective. Therefore, in addition to the financial statements explained above, this financial report includes two additional Required Supplementary Information schedules with historical trend information.

The Schedule of Funding Progress includes actuarial information about the status of the plan from an ongoing, long-term perspective and the progress made in accumulating sufficient assets to pay pension benefits when due. Valuation Assets approximately equal to Actuarial Accrued Liabilities indicate that sufficient assets exist to fund future pension benefits of the current members and benefits recipients.

The Schedule of Employer Contributions presents historical trend information regarding the value of total annual contributions required to be paid by the Utility Board and the actual performance of the Utility Board in meeting this requirement.

The Notes to Required Supplementary Information provide background information and explanatory detail to aid in understanding the required supplementary schedules.

Financial highlights

The net assets of the Plan exceeded its liabilities at the close of the fiscal years ended December 31, 2004 and 2003, with \$51,271,516 and \$49,534,465, respectively, in net assets held in trust for pension benefits.

Net assets increased by \$1,737,051, or 3.5% during 2004, primarily due to the Employer contribution along with positive investment performance.

The Plan's funding objective is to meet long-term benefit obligations. As of January 1, 2005, the date of the latest actuarial valuation, the funded ratio of the Plan was 92.2%. In general, this means that for every dollar of pension benefits due, the Plan has \$0.92 of net assets available for payment.

Additions to plan net assets for the year ended December 31, 2004 were \$4,374,972, which include contributions of \$1,910,640 and net gains from investment activities totaling \$2,464,332.

Deductions from plan net assets increased from \$2,441,311 during 2003 to \$2,637,921 in 2004 or about 8.1%. Most of the increase relates to increased benefit payments to new and existing retirees in 2004.

Analysis of financial activities

The Plan's funding objective is to meet long-term benefit obligations through investment income and contributions. Accordingly, the collection of contributions and the income from investments provide the reserves needed to finance future retirement benefits. After declines in 2001 and 2002, improved financial markets in 2003 and 2004 produced positive return. Net assets held in trust for pension benefits rose by \$1,737,051 in 2004 and \$7,274,793 in 2003.

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Since these net assets are used to meet ongoing benefit obligations to plan participants and their beneficiaries, the positive returns have improved the Plan's funding status.

Net Assets (Table 1)				
As of December 31, 2004 and 2003				
	<u>2004</u>	<u>2003</u>	<u>Increase (Decrease) Amount</u>	<u>Increase (Decrease) Percentage</u>
Current and other assets	\$ 2,390,124	\$ 853,728	\$1,536,396	180.0%
Investments, at fair value	49,692,611	48,680,737	1,011,874	2.1%
Total liabilities	<u>(811,219)</u>	<u>0</u>	<u>(811,219)</u>	<u>100.0%</u>
Net Assets	<u>\$ 51,271,516</u>	<u>\$ 49,534,465</u>	<u>\$1,737,051</u>	<u>3.5%</u>

As the years roll forward and the total assets and liabilities grow, the Plan's investment income will play a more significant roll in funding future retirement benefits – eventually providing 80 to 90 percent of the necessary funds. Therefore, investment return over the long term is critical to the funding status of the retirement Plan.

In 2004, investments were recorded on the settlement date rather than the trade date. This is in accordance with Generally Accepted Accounting Practices (GAAP). This resulted in a pending trade receivable of \$1,168,874 and a liability for pending trades in the amount of \$811,219.

During 2004, the Plan's investment portfolio returned net gains of approximately 5.2%. This is the second year in a row net gains are available to offset investment losses incurred in previous years and improved the Plan's financial position. It is important to remember that a retirement Plan's funding is based on a long time horizon, where temporary ups and downs in the market are expected. The more critical factor is that the Plan be able to meet an expected earnings yield of 8.0% annual return on investments. The Plan's 3 and 5-year returns have been 3.3% and 1.5%, respectively.

Based on our latest actuarial valuation as of January 1, 2005, the Plan's actuarial value of liabilities of \$57,511 thousand exceeds its actuarial value of assets of \$53,036 thousand by \$4,475 thousand, producing a funded ratio of 92.2 percent. The funded ratio is a key indication of financial strength of a retirement Fund and analyzing this percentage over time indicates whether the Plan is becoming stronger or weaker. Investment losses incurred in the previous years and recent benefit improvements have caused a downward trend in the funded ratio for recent years.

Net assets

The Plan's net assets are established from contributions and the accumulation of investment income, net of investment and administrative expenses and benefit payments.

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Additions to plan net assets

As noted above, the net assets needed to finance retirement benefits are accumulated through the collection of contributions and through investment earnings (net of investment expenses.) The additions totaled \$4,374,972 for the year ended December 31, 2004. This was \$5,341,132 less than the prior year primarily due to lower investment earnings.

Additions to Net Assets (Table 2)				
For the Years Ended December 31, 2004 and 2003				
	<u>2004</u>	<u>2003</u>	<u>Increase (Decrease) Amount</u>	<u>Increase (Decrease) Percentage</u>
Employer contributions	\$1,910,640	\$1,660,627	\$ 250,013	15.1%
Investment income	2,829,569	8,384,168	(5,554,599)	(66.3%)
Investment expenses	<u>(365,237)</u>	<u>(328,691)</u>	<u>(36,546)</u>	<u>(11.1%)</u>
Total additions	<u>\$4,374,972</u>	<u>\$9,716,104</u>	<u>\$(5,341,132)</u>	<u>(55.0%)</u>

Deductions from plan net assets

The Plan was created to provide retirement, survivor and disability benefits to qualified members and their beneficiaries. The cost of such programs includes recurring benefit payments and the cost of administering the Plan.

Deductions from Net Assets (Table 3)				
For the Years Ended December 31, 2004 and 2003				
	<u>2004</u>	<u>2003</u>	<u>Increase (Decrease) Amount</u>	<u>Increase (Decrease) Percentage</u>
Benefit payments	\$ 2,553,007	\$ 2,396,683	\$156,324	6.5%
Administrative expenses	<u>84,914</u>	<u>44,628</u>	<u>40,286</u>	<u>90.3%</u>
Total deductions	<u>\$ 2,637,921</u>	<u>\$ 2,441,311</u>	<u>\$196,610</u>	<u>8.1%</u>

Expenses for the year ended December 31, 2004 totaled \$2,637,921, an increase of 8.1% from 2003. This increase was primarily due to additional benefit payments to new and existing retirees in 2004. The net of deductions of plan net assets of \$2,637,921 and additions to plan net assets of \$4,374,972 resulted in an overall increase of \$1,737,051 in net assets held in trust for pension benefits for the year ended December 31, 2004. The Plan has consistently managed its administrative expenses, with no material variances.

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Fiduciary responsibilities

The Board of Trustees is the fiduciary of the pension trust fund. Fiduciaries are charged with the responsibility of assuring that the assets of the Plan are used exclusively for the benefit of plan participants and their beneficiaries.

Requests for information

This financial report is designed to provide the Board of Trustees, our membership, Utility Board and investment managers with an overview of the Plan's finances and accountability for the money received. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to:

Jack Wetzler, Plan Secretary/ Treasurer

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