Note M – Hedging Activities

OUC manages the impacts of interest rate and fuel market fluctuations on its earnings, cash flows and market value of assets and liabilities through its hedging programs.

Interest rate hedges: Interest rate risk for variable rate debt is managed through the execution of interest rate swap agreements (swaps). Swaps are executed in accordance with the Audit-Finance Committee Charter, reviewed on a quarterly basis by the Audit-Finance Committee and approved by the Board. Swaps are initiated in conjunction with bond transactions and as such, have inception and termination dates that align with the underlying debt series. Early termination of a swap can be executed in accordance with the terms of the agreement.

The Audit-Finance Committee Charter requires counterparty creditworthiness to achieve at least an "A" rating category from at least two of the three nationally recognized rating agencies, at the time of execution, maintaining a rating for qualified swap providers. In addition, two-way credit support agreements may be required with parental guarantees and/or letters of credit or collateral. In respect to the fair value of swaps, the value of these agreements takes into consideration the prevailing interest-rate environment and the specific terms and conditions of each contract. Fair value amounts are estimated using the zero-coupon discounting method, including utilizing option pricing models, which consider probabilities, volatility, time, underlying prices and other variables.

Fuel rate hedges: Fuel hedge risk is managed through the Energy Risk Management Committee (ERMOC) with Audit-Finance Committee oversight. ERMOC's responsibilities include establishing volume and financial limits, as well as overall program compliance and counterparty creditworthiness. Counterparty creditworthiness is evaluated considering the market segment, financial ratios, agency and market implied ratings and other factors.

As a result of engaging in hedging activities, OUC is subject to the following key risks:

- **Credit risk:** OUC addresses this risk through creditworthiness criteria included in its Finance Committee Charter and responsibilities of the ERMOC. Interest rate counterparties must have minimum credit ratings of "A-", issued by Standard and Poor's or Fitch Ratings or "A3", issued by Moody's Investors Service at the time the agreement is executed.
- **Interest rate risk:** OUC is exposed to this risk through its pay-fixed receive variable rate swaps and mitigates this risk through active management. There is no exposure to this risk for fuel hedges.
- **Basis risk:** OUC is exposed to this risk on its interest rate swap associated with the Series 2015B Bonds, as the variable-rate index received by OUC differs from the rate paid on the swap. OUC is exposed to this risk for fuel hedges due to a difference in commodity value between different delivery points or between cash market prices and the pricing points used in the financial markets. Basis risk is mitigated through active management.
- **Termination risk:** This risk is mitigated through OUC's creditworthiness criteria. To date, no instances of this nature have occurred.
- **Rollover risk:** OUC is not exposed to this risk as all derivative instruments are hedged to maturity.
- **Market access risk:** OUC maintains a strong credit rating; "AA" from Standard & Poor's and Fitch Ratings and "Aa2" from Moody's Investors Service and to date, has not encountered any market barriers or credit market challenges.

In accordance with accounting guidance, outstanding derivatives are evaluated and classified as either hedging derivative instruments (effective) or investment derivative instruments (ineffective), with the accumulated change in fair market value recognized as deferred inflows/outflows of resources or investment income/expense, respectively.

Interest rate derivatives: As of September 30, 2022 and 2021, OUC's interest rate swap related to the Series 2015B Bonds have been determined to be effective and changes in the fair value of these derivatives were included on the Statements of Net Position. As of September 30, 2021, the 2021A forward interest rate swap was terminated in conjunction with the Series 2021A Bond issuance.

Note M – Hedging Activities (continued)

The following statement summarizes the interest rate derivative contracts outstanding for the years ended September 30:

(Dollars in thousands)	2021 Fair value	Change in fair value	Settlement/ (Termination) amount	2022 Fair value	Net settlement charges	Notional amount
Interest rate swap agreements						
2015B Bonds [1]	$ (4,385)	$ 15,102	$ —	$ 10,717	$ —	$ 115,090
Total (liability)/asset	**$ (4,385)**	**$ 15,102**	**$ —**	**$ 10,717**	**$ —**	

(Dollars in thousands)	2020 Fair value	Change in fair value	Settlement/ (Termination) amount	2021 Fair value	Net settlement charges	Notional amount
Interest rate swap agreements						
2015B Bonds [1]	$ (10,765)	$ 6,380	$ —	$ (4,385)	$ —	$ 115,090
Forward interest rate contracts						
2021A Bonds [1]	(12,647)	4,361	8,286	—	—	$ 150,000
Total (liability)/asset	**$ (23,412)**	**$ 10,741**	**$ 8,286**	**$ (4,385)**	**$ —**	

[1] See Note H for additional information.

Fuel derivatives: Fuel derivatives are settled in the period in which the option expires and are recognized as fuel expenses on the Statements of Revenues, Expenses and Changes in Net Position. For the year ended September 30, 2022 and 2021, settlement gains for fuel-related derivatives were $36.0 million and $8.6 million, respectively. The outstanding fuel derivatives were determined to be effective, and as such, the changes in fair value have been recorded on the Statements of Net Position as either a deferred outflow of resources or deferred inflow of resources until such time as the contracts mature. The following is a summary of the fuel-related derivative transactions for the years ended September 30:

(Dollars in thousands)	2021 Fair value	Change in fair value	2022 Fair value	2022 Notional amount	Volume [1]
Current natural gas fuel hedge assets	$ 18,903	$ 1,233	$ 20,136	$ 7,060	MMBTU
Non-current natural gas fuel hedge assets	20,209	27,279	47,488	$ 23,280	MMBTU
Accumulated increase in fair value hedging derivatives	**$ 39,112**	**$ 28,512**	**$ 67,624**		
Current natural gas fuel hedge liabilities	$ —	$ (1,205)	$ (1,205)	$ 2,640	MMBTU
Non-current natural gas fuel hedge liabilities	—	—	—	$ —	MMBTU
Accumulated decrease in fair value hedging derivatives	**$ —**	**$ (1,205)**	**$ (1,205)**		

(Dollars in thousands)	2020 Fair value	Change in fair value	2021 Fair value	2021 Notional amount	Volume [1]
Current natural gas fuel hedge assets	$ 2,343	$ 16,560	$ 18,903	$ 9,140	MMBTU
Non-current natural gas fuel hedge assets	2,406	17,803	20,209	$ 30,250	MMBTU
Accumulated increase in fair value hedging derivatives	**$ 4,749**	**$ 34,363**	**$ 39,112**		
Current natural gas fuel hedge liabilities	$ (96)	$ 96	$ —	$ —	MMBTU
Non-current natural gas fuel hedge liabilities	(1,722)	1,722	—	$ —	MMBTU
Accumulated decrease in fair value hedging derivatives	**$ (1,818)**	**$ 1,818**	**$ —**		

[1] Million British Thermal Units (MMBTU)

Long-term Employee Benefit Plans

Schedule of changes in net pension liability/(asset) (NPL/NPA), total pension liability (TPL), net OPEB liability/(asset) (NOL/NOA) and related ratios: The following schedules present multi-year trend information that demonstrate the components of change in the TPL, NPL/NPA and NOL/NOA from year to year, as well as trends in related statistical information. Information is presented related to all periods for which the required data is available. Amounts presented are determined as of the measurement date for September 30:

Pension Plan **(Dollars in thousands)**	**2022**	**2021**	**2020**	**2019**	**2018**	**2017**	**2016**	**2015**
Total pension liability								
Service cost	$ 6,820	$ 5,814	$ 5,867	$ 5,754	$ 5,748	$ 5,539	$ 5,570	$ 5,9
Interest on the total pension liability	35,816	36,079	35,407	34,492	33,535	32,767	32,104	29,8
Benefit changes	—	—	68	—	408	—	—	15,1
Difference between expected and actual experience	(640)	(2,073)	2,106	4,904	3,706	(106)	(2,501)	(2,5
Assumption changes	10,398	(9,708)	—	—	—	171	29,125	(14,4
Benefit payments, including refunds of plan member contributions	(34,810)	(34,671)	(33,576)	(31,726)	(28,663)	(27,324)	(25,773)	(23,0
Net change in total pension liability	**17,584**	**(4,559)**	**9,872**	**13,424**	**14,734**	**11,047**	**38,525**	**10,9**
Total pension liability - beginning of year	**504,602**	**509,161**	**499,289**	**485,865**	**471,131**	**460,084**	**421,559**	**410,6**
Total pension liability - end of year	**$ 522,186**	**$ 504,602**	**$ 509,161**	**$ 499,289**	**$ 485,865**	**$ 471,131**	**$ 460,084**	**$ 421,5**
Plan fiduciary net position								
Contributions - employer	$ 19,173	$ 22,405	$ 22,491	$ 22,614	$ 21,876	$ 17,803	$ 18,573	$ 21,1
Contributions - plan members	369	423	475	555	660	748	821	8
Total investment income, net of investment expense	95,240	46,228	17,599	37,039	48,761	29,872	4,783	28,9
Benefit payments, including refunds of plan member contributions	(34,810)	(34,671)	(33,576)	(31,726)	(28,663)	(27,324)	(25,773)	(23,0
Administrative expense	(323)	(242)	(240)	(320)	(115)	(36)	(122)	(
Net change in plan fiduciary net position	**79,649**	**34,143**	**6,749**	**28,162**	**42,519**	**21,063**	**(1,718)**	**27,8**
Plan fiduciary net position - beginning of year	**459,909**	**425,766**	**419,017**	**390,855**	**348,336**	**327,273**	**328,991**	**301,1**
Plan fiduciary net position - end of year	**$ 539,558**	**$ 459,909**	**$ 425,766**	**$ 419,017**	**$ 390,855**	**$ 348,336**	**$ 327,273**	**$ 328,9**
Net pension liability - beginning of year	**$ 44,693**	**$ 83,395**	**$ 80,272**	**$ 95,010**	**$ 122,795**	**$ 132,811**	**$ 92,568**	**$ 109,45**
Net pension (asset)/liability - end of year	**$ (17,372)**	**$ 44,693**	**$ 83,395**	**$ 80,272**	**$ 95,010**	**$ 122,795**	**$ 132,811**	**$ 92,56**
Plan fiduciary net position as a percentage of total pension liability	**103.3%**	**91.1%**	**83.6%**	**83.9%**	**80.5%**	**73.9%**	**71.1%**	**78.0%**
Covered payroll	**$ 100,621**	**$ 97,896**	**$ 90,907**	**$ 86,573**	**$ 78,314**	**$ 75,405**	**$ 72,479**	**$ 70,14**
Net pension (asset)/liability as a percentage of covered payroll	**(17.3)%**	**45.7%**	**91.7%**	**92.7%**	**121.3%**	**162.8%**	**183.2%**	**132.0%**

415 Trust[1] **(Dollars in thousands)**	**2022**	**2021**	**2020**	**2019**	**2018**	**2017**	**2016**
Total pension liability							
Service cost	$ 75	$ 57	$ 40	$ 36	$ 28	$ 22	$ 21
Interest on the total pension liability	80	82	99	91	38	41	40
Benefit changes	—	—	—	—	1,124	—	—
Difference between expected and actual experience	(190)	27	64	82	373	47	—
Assumption changes	87	320	350	(96)	(132)	97	—
Benefit payments, including refunds of plan member contributions	(168)	(160)	(157)	(118)	(80)	(51)	(56)
Net change in total pension liability	**(116)**	**326**	**396**	**(5)**	**1,351**	**156**	**5**
Total pension liability - beginning of year	**3,330**	**3,004**	**2,608**	**2,613**	**1,262**	**1,106**	**1,101**
Total pension liability - end of year	**$ 3,214**	**$ 3,330**	**$ 3,004**	**$ 2,608**	**$ 2,613**	**$ 1,262**	**$ 1,106**
Covered payroll	**$ 937**	**$ 905**	**$ 905**	**$ 1,114**	**$ 1,458**	**$ 920**	**$ 804**
Total pension liability as a percentage of covered payroll	**343.1 %**	**367.9 %**	**331.9 %**	**234.1 %**	**179.2 %**	**137.2 %**	**137.6 %**

[1] For the non-qualified plan, there were no assets accumulated in a trust that meet the criteria in GASB Statement No. 73, "*Accounting and Financia Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASE Statements 67 and 68,*" to pay related benefits. As such, assets were reported in OUC's financial statements and were not netted against the total pensior liability.

Long-term Employee Benefit Plans (continued)

EB plan

ıllars in thousands)	2022	2021	2020	2019	2018	2017	2016
al OPEB liability							
ervice cost	$ 1,039	$ 1,174	$ 1,186	$ 1,308	$ 1,331	$ 1,346	$ 1,480
ıterest on the total OPEB liability	8,620	9,936	9,906	10,385	10,434	11,882	12,134
enefit changes	—	(438)	—	—	—	—	—
ifference between expected and actual experience	(5,592)	2,899	(2,192)	(2,987)	(3,285)	(23,970)	3,536
ssumption changes	(8,028)	(24,688)	(1,029)	(7,658)	(2,093)	(2,670)	(452)
enefit payments, including refunds	(6,291)	(7,511)	(7,371)	(7,702)	(6,374)	(8,063)	(9,067)
let change in total OPEB liability	(10,252)	(18,628)	500	(6,654)	13	(21,475)	7,631
tal OPEB liability - beginning of year	121,006	139,634	139,134	145,788	145,775	167,250	159,619
tal OPEB liability - end of year	**$ 110,754**	**$ 121,006**	**$ 139,634**	**$ 139,134**	**$ 145,788**	**$ 145,775**	**$ 167,250**
ın fiduciary net position							
Contributions - employer	$ 1,185	$ 3,682	$ 7,022	$ 9,068	$ 13,384	$ 12,628	$ 14,117
Net investment income/(loss)	31,313	14,953	5,399	10,956	13,420	9,621	(1,195)
Benefit payments, including refunds	(6,291)	(7,511)	(7,371)	(7,702)	(6,374)	(8,062)	(9,067)
Administrative expense	(17)	(17)	(17)	(18)	(18)	(18)	(32)
Net increase in plan fiduciary net position	26,190	11,107	5,033	12,304	20,412	14,169	3,823
an fiduciary net position - beginning of year	149,086	137,979	132,946	120,642	100,230	86,061	82,238
an fiduciary net position - end of year	**$ 175,276**	**$ 149,086**	**$ 137,979**	**$ 132,946**	**$ 120,642**	**$ 100,230**	**$ 86,061**
t OPEB (asset)/liability - beginning of year	**$ (28,080)**	**$ 1,655**	**$ 6,188**	**$ 25,146**	**$ 45,545**	**$ 81,189**	**$ 77,381**
t OPEB (asset)/liability - end of year	**$ (64,522)**	**$ (28,080)**	**$ 1,655**	**$ 6,188**	**$ 25,146**	**$ 45,545**	**$ 81,189**
an fiduciary net position as a percentage of total OPEB liability	**158.3%**	**123.2%**	**98.8%**	**95.6%**	**82.8%**	**68.8%**	**51.5%**
overed payroll	**$ 100,721**	**$ 98,058**	**$ 91,035**	**$ 86,892**	**$ 78,447**	**$ 71,856**	**$ 72,990**
t OPEB (asset)/liability as a percentage of covered payroll	**(64.1)%**	**(28.6)%**	**1.8%**	**7.1%**	**32.1%**	**63.4%**	**111.2%**

Notes to schedule

Benefit changes: There were no benefit changes in 2022. In 2021, benefit changes were made to remove the premium POS healthcare option and to revise utility discount maximums. In 2020, various administrative plan changes were implemented related to the calculation of cash balance notional accounts and cash balance benefit payments which were initially approved by the Board in 2017 to facilitate compliance with IRS Section 401(a)(17).

Assumption changes: For 2022, changes in assumptions included claim costs and premium amounts for the self-insured health plan, premiums for the fully insured Medicare Advantage plan, long-term medical trend rates and the annual trend for dental costs. For 2021, assumption changes were made to salary increases and retirement, separation and mortality rates based on an actuarial assumption study and experience review for the seven-year period ending September 30, 2019, as adopted by the Pension and OPEB Plan Trustees. Additional assumption revisions to initial claim costs for the core plan assumed premiums for the fully-insured Medicare Advantage plan and healthcare cost trends were included in the September 30, 2020 OPEB valuation. In August 2015, a similar assumption study and experience review for the six-year period ended September 30, 2014 was completed and changes were implemented effective September 30, 2015 to the salary, retirement, termination and mortality assumptions.

The investment return rate was 7.0 percent and 7.25 percent as of the September 30, 2021 and 2020 valuation dates, respectively. As the plan fiduciary net positions were projected to be available to make all projected benefit payments, the single discount rate was also 7.0 percent and 7.25 percent as of September 30, 2021 and 2020, respectively.

Long-term Employee Benefit Plans (continued)

Schedule of employer contributions to the pension plan: The following schedule presents multi-year trend information regarding employer contributions to the plans for the years ended September 30:

Contribution year (Dollars in thousands)	Actuarially determined contribution	Actual contribution	Contribution deficiency/ (excess)	Covered payroll	Contributions as a percentage of CP	Annual money-weighted return on investments
Pension plan						
2022	$ 17,678	$ 17,678	$ —	$ 103,139	17.1%	-17.0%
2021	$ 19,173	$ 19,173	$ —	$ 100,621	19.1%	21.2%
2020	$ 22,405	$ 22,405	$ —	$ 97,896	22.9%	11.0%
2019	$ 22,491	$ 22,491	$ —	$ 90,907	24.7%	4.2%
2018	$ 22,614	$ 22,614	$ —	$ 86,573	26.1%	9.6%
2017	$ 21,876	$ 21,876	$ —	$ 78,314	27.9%	14.2%
2016	$ 18,322	$ 17,803	$ 519	$ 75,405	23.6%	9.2%
2015	$ 20,500	$ 18,573	$ 1,927	$ 72,479	25.6%	1.4%
2014	$ 21,184	$ 21,198	$ (14)	$ 70,147	30.2%	9.6%
2013	$ 18,893	$ 17,729	$ 1,164	$ 73,230	24.2%	12.8%
OPEB plan						
2022	$ 1,133	$ 1,133	$ —	$ 100,061	1.1%	-18.1%
2021	$ 1,185	$ 1,185	$ —	$ 100,721	1.2%	21.4%
2020	$ 3,682	$ 3,682	$ —	$ 98,058	3.8%	10.9%
2019	$ 7,022	$ 7,022	$ —	$ 91,035	7.7%	4.0%
2018	$ 9,068	$ 9,068	$ —	$ 86,892	10.4%	9.0%
2017	$ 13,384	$ 13,384	$ —	$ 78,447	17.1%	13.2%
2016	$ 12,628	$ 12,628	$ —	$ 71,856	17.6%	11.0%
2015	$ 14,117	$ 14,117	$ —	$ 72,990	19.3%	-1.4%
2014	$ 13,558	$ 13,558	$ —	$ 72,990	18.6%	10.2%
2013	$ 14,358	$ 14,325	$ (33)	$ 70,692	20.3%	13.0%

Notes to schedule

The actuarially determined contribution rates were calculated as of October 1 of the year preceding the contribution year, using the following assumptions:

Actuarial cost method: Entry Age Normal

Amortization method and remaining amortization period: Level dollar, closed and 15 years

Asset valuation method: 20.0 percent of the difference between expected actuarial value (based on assumed return) and market value is recognized each year with 10.0 percent corridor around market value.

Inflation: 2.25 percent intermediate, 2.50 percent long term

Salary increases: 4.5 percent to 10.0 percent depending on age and benefit offering group, including inflation

Investment rate of return: 7.25 percent

Retirement age: Experience-based table of rates

Mortality: PUB-2010 Headcount Weighted General Below Median Employee Mortality Table (for pre-retirement mortality) and PUB-2010 Headcount Weighted General Below Median Healthy Retiree Mortality Table (for post-retirement mortality), with separate rates for males and females and ages set back one year for males, with mortality improvements projected to all future years after 2010 using Scale MP-2018.

COLA: 1.5 percent per year, based on actual COLA granted for the year, and 1.0 percent per year, compounded annually for each year thereafter, for the traditional defined benefit offering only.

Healthcare cost trend rate: Based on the Getzen Model, with trend starting at 6.25 percent and gradually decreasing to an ultimate trend rate of 3.99 percent.

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Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

To Management and the Commissioners of Orlando Utilities
Commission

We have audited, 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, the financial statements of the business-type activities and fiduciary activities of Orlando Utilities Commission (OUC) as of and for the years ended September 30, 2022 and 2021, and the related notes to the financial statements, which collectively comprise OUC's basic financial statements, and have issued our report thereon dated January 17, 2023.

Report on Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered OUC's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of OUC's internal control. Accordingly, we do not express an opinion on the effectiveness of OUC's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses or significant deficiencies may exist that have not been identified.

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Report on Compliance and Other Matters

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

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Ernst + Young LLP

January 17, 2023