

**WISCONSIN PUBLIC POWER INC.**

Financial Statements

December 31, 2005 and 2004

(With Independent Auditors' Report Thereon)

# WISCONSIN PUBLIC POWER INC.

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**KPMG LLP**  
4200 Wells Fargo Center  
90 South Seventh Street  
Minneapolis, MN 55402

## **Independent Auditors' Report**

The Board of Directors  
Wisconsin Public Power Inc.:

We have audited the accompanying balance sheets of Wisconsin Public Power Inc. (WPPI) as of December 31, 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 WPPI's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of American Transmission Company LLC (ATC) (a 5.2%-owned investee company). WPPI's investment in ATC at December 31, 2005 and 2004 was \$32,257,900 and \$26,975,087, respectively, and its equity in earnings of ATC was \$5,061,484 and \$4,230,530 for the years ended December 31, 2005 and 2004, respectively. The financial statements of ATC were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for ATC, is based solely on the report of the other auditors.

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 audits 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 WPPI'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 and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of WPPI as of December 31, 2005 and 2004, and the changes in its financial position and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

The management's discussion and analysis on pages 2 through 20 is not a required part of the basic financial statements of WPPI but is supplementary information required by U.S. generally accepted accounting principles. 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 the information and express no opinion on it.

**KPMG LLP**

February 24, 2006

**WISCONSIN PUBLIC POWER INC.**

Management's Discussion and Analysis

December 31, 2005 and 2004

**Financial Statement Overview**

This discussion and analysis provides an overview of the financial performance of Wisconsin Public Power Inc. (WPPI) for the years ended December 31, 2005 and 2004. The information presented should be read in conjunction with WPPI's financial statements and the accompanying notes.

WPPI follows the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission. The financial statements are prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles.

WPPI's financial statements include the Balance Sheets; the Statements of Revenues, Expenses, and Changes in Net Assets; and the Statements of Cash Flows. The Balance Sheets provide information about the nature and amount of assets and obligations (liabilities) of WPPI as of the end of the year. The Statements of Revenues, Expenses, and Changes in Net Assets report revenues and expenses for the current year. The Statements of Cash Flows report cash receipts, cash payments, and net changes in cash resulting from operating, noncapital financing, investing, and capital and related financing activities.

**WISCONSIN PUBLIC POWER INC.**

Management's Discussion and Analysis

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**Financial Changes in 2005 from 2004**

The following table summarizes the financial position of WPPI as of December 31, 2005 and 2004:

**Condensed Balance Sheets**

Assets	2005	2004	Dollar change	Percentage change
Capital assets, net of accumulated depreciation	\$ 152,374,780	129,727,892	22,646,888	17.5%
Noncurrent assets	256,907,013	82,119,841	174,787,172	212.8
Deferred costs	29,974,277	27,171,118	2,803,159	10.3
Current assets	<u>102,961,808</u>	<u>44,639,286</u>	<u>58,322,522</u>	130.7
Total assets	<u>\$ 542,217,878</u>	<u>283,658,137</u>	<u>258,559,741</u>	91.2
<b>Liabilities and Net Assets</b>				
Long-term debt	\$ 393,566,717	158,273,732	235,292,985	148.7
Rate stabilization	35,756,677	35,127,846	628,831	1.8
Other deferred credits and liabilities	12,869,345	11,168,980	1,700,365	15.2
Current liabilities	<u>42,282,486</u>	<u>27,974,279</u>	<u>14,308,207</u>	51.1
Total liabilities	<u>484,475,225</u>	<u>232,544,837</u>	<u>251,930,388</u>	108.3
<b>Net assets</b>				
Invested in capital assets, net of related debt	(75,014,999)	(30,460,234)	(44,554,765)	146.3
Restricted	107,860,040	53,218,725	54,641,315	102.7
Unrestricted	<u>24,897,612</u>	<u>28,354,809</u>	<u>(3,457,197)</u>	(12.2)
Total net assets	<u>57,742,653</u>	<u>51,113,300</u>	<u>6,629,353</u>	13.0
Total liabilities and net assets	<u>\$ 542,217,878</u>	<u>283,658,137</u>	<u>258,559,741</u>	91.2

**Total Assets**

Total assets increased by approximately \$258.6 million due primarily to WPPI issuing \$236.92 million in bonds, including a premium of approximately \$5.2 million, for total proceeds of approximately \$242.1 million, to fund the acquisition of an approximately 51 MW share in each of Elm Road Generating Station Units 1 and 2 that are being constructed in Oak Creek, Wisconsin. Construction started in mid-2005 and is expected to continue through mid-2009 for Unit 1 and mid-2010 for Unit 2. WPPI has budgeted \$210.5 million for estimated construction costs and contingencies, which will be funded by bond proceeds of approximately \$193.4 million and interest earnings on the bond proceeds of approximately \$17.1 million. The remainder of the bonds were issued to cover capitalized interest of approximately \$37.0 million, a debt service reserve of approximately \$8.2 million, and costs of issuance of approximately \$3.5 million.

Each line item that is part of the condensed balance sheets in the financial statements is discussed in more detail in the following sections. All amounts have been rounded to the nearest \$0.1 million.

## **WISCONSIN PUBLIC POWER INC.**

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#### **Capital Assets**

Capital assets net of accumulated depreciation increased by approximately \$22.6 million. Within this category, electric plant and equipment increased a net of \$0.1 million from approximately \$208.9 million in 2004 to \$209.0 million in 2005. The increase was attributable primarily to the purchase of a van to WPPI's second metering technician with a vehicle and metering equipment for WPPI metering points.

Accumulated depreciation and amortization increased from approximately \$79.2 million in 2004 to approximately \$85.3 million in 2005, or approximately \$6.1 million. Major components of this increase include approximately \$2.6 million in accumulated depreciation for Boswell 4, approximately \$1.1 million in accumulated depreciation for South Fond du Lac 1, approximately \$1.2 million in accumulated depreciation for South Fond du Lac 4, approximately \$0.8 million in accumulated depreciation for the Island Street Peaking Plant, approximately \$0.1 million in accumulated depreciation for the Worthington Wind Turbines, and approximately \$0.4 million in accumulated depreciation for computer equipment.

Construction work in progress increased by approximately \$28.6 million, from approximately \$0.1 million in 2004 to approximately \$28.7 million in 2005. Approximately \$28.1 million of the increase was construction work in progress on Elm Road Generating Station Units 1 and 2, approximately \$0.5 million of the increase was costs of preliminary work on the Prairie State Generating Project, and approximately \$0.1 million of the increase was construction work in progress on Boswell 4.

#### **Noncurrent Assets**

Total noncurrent assets increased by approximately \$174.8 million, from approximately \$82.1 million in 2004 to approximately \$256.9 million in 2005, consisting of an increase of approximately \$175.6 million in noncurrent cash and investments, a decrease of less than \$0.1 million in interest receivable, a decrease of approximately \$5.9 million in investments held, an increase of approximately \$5.3 million in the investment in the American Transmission Company, and a decrease of approximately \$0.2 million in Rate Stabilization Contributions receivable from members, as discussed in the following paragraphs.

Noncurrent restricted cash and investments increased from approximately \$48.3 million in 2004 to approximately \$223.9 million in 2005, or a total of \$175.6 million, primarily due to the issue of the series 2005 A and 2005 B bonds. Changes in the composition of noncurrent restricted cash and investments detailed in footnote 2 are discussed in the paragraphs that follow.

Cash and investments in the Renewal and Replacement Fund increased by approximately \$3.6 million from approximately \$2.3 million in 2004 to approximately \$5.9 million in 2005 as a result of deposits made during 2005 for Boswell 4, the South Fond du Lac units, and the Island Street Peaking Plant.

Cash and investments in the Self-Insurance Fund increased by approximately \$1.0 million from approximately \$2.1 million in 2004 to approximately \$3.1 million in 2005 due to deposits to the Self-Insurance Fund out of 2004 net earnings that occurred in 2005, and from interest earnings that are retained in the fund.

Cash and investments in the Rate Stabilization Fund increased by approximately \$1.7 million, from approximately \$33.7 million in 2004 to approximately \$35.4 million in 2005. The increase in cash was a result of deposits made for new Members of approximately \$0.6 million, plus continuing deposits of approximately \$0.8 million from Members that joined WPPI several years prior who opted to make Rate Stabilization Fund

## **WISCONSIN PUBLIC POWER INC.**

### Management's Discussion and Analysis

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deposits on a schedule, and a deposit of approximately \$0.4 million from year-end 2004 deferrals of net income. The increases were offset slightly by mark to market calculations on investments held in the Rate Stabilization Fund, which decreased the fund by approximately \$0.2 million, resulting in the net increase, after rounding, of approximately \$1.7 million in 2005.

Cash and investments in the Decommissioning Fund increased by approximately \$0.2 million, including approximately \$0.1 million deposited from member revenues and \$0.1 million deposited from interest earnings. These deposits brought the balance to approximately \$2.3 million in 2005 from approximately \$2.1 million in 2004.

Noncurrent Construction Fund cash and investments increased by approximately \$135.0 million, from \$0.0 in 2004 to approximately \$135.0 million in 2005. These funds came from bond proceeds for the Elm Road Generating Station project.

Noncurrent Debt Service Funds cash and investments increased by approximately \$25.3 million, from \$0.0 in 2004 to approximately \$25.3 million in 2005. These funds came from bond proceeds for the Elm Road Generating Station project.

Noncurrent Debt Service Reserve Funds cash and investments increased by approximately \$8.8 million, from approximately \$8.1 million in 2004 to approximately \$16.9 million in 2005. These funds came from approximately \$8.2 million bond proceeds for the Elm Road Generating Station project and approximately \$0.6 million in interest earnings on the 2003 Series A, B, and C, and 2005 Series A and B Debt Service Reserve Funds.

Noncurrent unrestricted investments decreased by approximately \$5.9 million, from approximately \$6.6 million in 2004 to approximately \$0.7 million in 2005, as a result of investments being held closer to maturity, which reclassifies them from the noncurrent investment category to the current assets category.

Investment in the American Transmission Company increased by approximately \$5.3 million, from approximately \$27.0 million in 2004 to approximately \$32.3 million in 2005. The increase came from approximately \$4.1 million in capital contributions by WPPI during 2005, with the remainder of approximately \$1.2 million representing 2005 earnings allocations that were retained by ATC and increased WPPI's ownership.

Noncurrent receivables from Members decreased by approximately \$0.2 million, from approximately \$0.2 million to just above \$0. The decrease was attributable to Plymouth Utilities making its final payments to the Rate Stabilization Fund as a new Member. Payments to the fund due from Oconto Falls, Prairie du Sac, and Reedsburg were moved to current receivables because they will be collected in 2006.

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### Management's Discussion and Analysis

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#### **Deferred Costs**

Unamortized bond issuance costs increased approximately \$3.3 million, from approximately \$2.6 million in 2004 to approximately \$5.9 million in 2005 as a result of approximately \$3.5 million in unamortized costs from the 2005 A and B bond issues, less approximately \$0.2 million in 2003 A, B, and C costs that were amortized in 2005.

Future recoverable costs represent the difference between depreciation and amortization of assets financed with bond proceeds and the related principal recovered in rates in the present period. These costs will be recovered in future periods when the principal amounts exceed the related depreciation and amortization, as allowed through the application of provisions under SFAS No. 71. Future recoverable costs increased by approximately \$0.7 million during 2005.

Other deferred charges decreased by approximately \$1.1 million, from approximately \$4.2 million in 2005 to approximately \$3.1 million in 2004, primarily as the result of amortizing approximately \$0.8 million for termination of a power purchase agreement with Menasha Utilities that started being amortized in 2005 on a 55-month amortization schedule, \$0.2 million in amortization for a capacity buyout agreement with Kaukauna Utilities that started in 2002 and is being amortized over 60 months.

#### **Current Assets**

Cash and investments increased approximately \$3.1 million, from approximately \$15.1 million in 2004 to approximately \$18.2 million in 2005. The total included \$6.5 million from WPPI's line of credit with Chase Bank.

Restricted cash and investments increased approximately \$45.3 million, from approximately \$6.0 million in 2004 to approximately \$51.3 million in 2005. The increase was attributable to cash from bond proceeds for construction funds expected to be used within 12 months of December 31, 2005 of approximately \$32.8 million, and capitalized interest due within 12 months of December 31, 2005 of approximately \$12.5 million.

Power sales accounts receivable increased approximately \$9.8 million, from approximately \$17.8 million in 2004 to approximately \$27.6 million in 2005. The increase was attributable to the higher cost of purchased power during December 2005, which was reflected on member invoices.

Other receivables decreased by approximately \$2.1 million, from slightly less than \$2.5 million in 2004 to approximately \$0.3 million in 2005. The decrease is a result of receivables from Members who joined in 2001 and 2002 being paid off in an amount of approximately \$0.7 million, and a decrease of approximately \$1.6 million in miscellaneous receivables consisting primarily of approximately \$1.4 million from Alliant Energy for overhaul costs of South Fond du Lac Combustion Turbine 4 and the remainder in numerous other smaller items.

Unrestricted interest receivable decreased by approximately \$0.1 million, from approximately \$0.4 million in 2004 to approximately \$0.3 million in 2003, primarily as a result of interest on the 2003 A, B, and C Debt Service Reserve Funds, which goes to the Revenue Fund, not being received by year-end 2004, but being received as the close of business in 2005.

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Restricted interest receivable increased approximately \$1.5 million, from just over \$0.0 million in 2004 to approximately \$1.5 million in 2005, primarily reflecting the reinvestment of interest earnings through December 31, 2005 on the 2005 A and B funds, which is restricted to those funds.

Inventories increased by approximately \$0.8 million, from approximately \$2.6 million in 2004 to approximately \$3.4 million in 2005 as a result of fuel stock increases at Boswell 4 and the Island Street Peaking Plant.

Prepayments increased less than \$0.1 million, rising from just over \$0.3 million in 2004 to just under \$0.4 million in 2005 primarily as a result of just over \$70,000 in January 2006 health insurance premiums paid in December 2005.

#### **Total Liabilities**

Total liabilities increased by approximately \$251.9 million due primarily to WPPI issuing \$236.92 million in bonds to fund the acquisition of an approximately 51 MW share in each of Elm Road Generating Station Units 1 and 2. WPPI has budgeted \$210.5 million for estimated construction costs and contingencies, which will be funded by bond proceeds of approximately \$193.4 million and interest earnings on the bond proceeds of approximately \$17.1 million. The remainder of the bonds were issued to cover capitalized interest of approximately \$37.0 million, a debt service reserve of approximately \$8.2 million, and costs of issuance of approximately \$3.5 million. Each line item that is part of the condensed balance sheets is discussed in more detail in the following sections.

#### **Long-Term Debt**

Revenue bonds net of unamortized premium increased by approximately \$235.3 million, from approximately \$158.3 million in 2004 to \$393.6 million in 2005. This increase included approximately \$236.9 million in new long-term debt for 2005 Series A and B, and approximately \$5.2 million for unamortized premium for Series 2005 A and B, amortization of the loss on reacquired debt for 2003 Series A, B and C of approximately \$1.3 million, the amortization of the loss on reacquired debt for 1993 Series A and B of approximately \$1.3 million. Decreases in the account included approximately \$0.9 million for amortization of the premium on Series 2003 A and the reclassification of approximately \$8.6 million in 2003 Series A, B and C principal to short-term debt.

#### **Rate Stabilization Fund**

The Rate Stabilization Fund increased by approximately \$0.6 million, from approximately \$35.1 million in 2004 to approximately \$35.8 million in 2005, due to payments from new Members.

#### **Other Deferred Credits and Liabilities**

Operating reserves and accrued liabilities increased approximately \$0.7 million, from approximately \$9.1 million in 2004 to approximately \$9.7 million in 2005. Increases included Renewal and Replacement Fund deposits for South Fond du Lac 1 of approximately \$0.7 million, South Fond du Lac 4 of approximately \$0.4 million, and the Self-Insurance Fund of approximately \$0.1 million, and Post Retirement Obligation and other miscellaneous accruals of approximately \$0.2 million. Decreases included use of approximately \$0.5 million in the Renewal and Replacement Fund for Boswell 4 for repairs during 2005, and Employee Retention Plan Fund payments.

## **WISCONSIN PUBLIC POWER INC.**

### Management's Discussion and Analysis

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The fair value of interest rate swap agreements decreased approximately \$0.9 million, from approximately negative \$0.3 million to approximately negative \$1.2 million as a result of a combination of swap value changes and recording of the 2005 B swap. The 2003 B swap increased in market value by approximately \$0.6 million, from approximately negative \$1.2 million in 2004 to approximately negative \$0.6 million in 2005. The 2003 C swap increased in market value by approximately \$0.3 million, from approximately \$0.9 million in 2004 to approximately \$1.2 million in 2005. The 2005 B swap was recorded at an initial value of approximately negative \$1.9 million on December 31, 2005. The value of the swaps to WPPI reflects changes in interest rates. If interest rates rise, the swaps will generally gain value, and if interest rates fall, the swaps will generally lose value.

The asset retirement obligation, which is the accrual of funds for retirement of the ash ponds at Boswell 4, increased approximately \$0.1 million as a result of monthly deferrals to the fund from ongoing revenue, plus interest earnings on the funds that remain in the fund.

#### **Current Liabilities**

Current maturities of long-term debt increased approximately \$3.0 million, from approximately \$5.6 million in 2004 to approximately \$8.6 million in 2005. Increases in the account reflected reclassification of approximately \$8.6 million in 2003 Series A, B and C maturities from long-term debt to short-term debt, and retirement of approximately \$5.6 million in 2003 Series A, B and C maturities.

Interest accrued increased by approximately \$1.1 million, from approximately \$2.3 million in 2004 to approximately \$3.4 million in 2005. This amount increased by approximately \$1.5 million for interest expense for 2005 Series A and B, offset by a decrease of approximately \$0.4 million for interest expense due on 2003 Series A, B and C.

The line of credit balance outstanding increased by \$6.5 million, from \$0.0 million in 2004 to \$6.5 million in 2005. WPPI established a \$5.0 million line of credit in June 2004 with Chase Bank, and increased it to \$10.0 million in March 2005.

Accounts payable increased by approximately \$6.5 million, from approximately \$16.2 million in 2004 to approximately \$22.3 million in 2005. The increase was attributable to the higher purchased power expense in the second half of 2005. WPPI also accrued approximately \$0.3 million for the Prairie State Energy Campus project for payment required with the Initial Interest Acquisition Notice, which was issued on December 30, 2005.

Other current liabilities decreased by approximately \$2.7 million, from approximately \$3.9 million in 2004 to approximately \$1.1 million in 2005. The majority of the decrease was due to the payment in 2005 of \$2.5 million to Menasha Utilities for the buyout of an output contract, and a lowering of the SEP-IRA Retirement Plan contribution liability of approximately \$0.2 million due to a shift in 2005 to monthly deposits from biannual deposits.

#### **Net Assets**

Net Assets invested in capital assets, net of related debt decreased by approximately \$44.6 million, from approximately negative \$30.5 million in 2004 to approximately negative \$75 million in 2005. The change was a result of a decrease in net electric plant and equipment of approximately \$6.0 million, an increase in unamortized bond issuance costs of \$3.3 million, and an increase in long-term debt of approximately \$236.1 million, offset by

**WISCONSIN PUBLIC POWER INC.**

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an increase in construction work in progress of approximately \$28.7 million and an increase in funds available for construction of approximately \$167.8 million.

Restricted net assets increased by approximately \$54.6 million, from approximately \$53.2 million in 2004 to approximately \$107.9 in 2005. The change was a result of an increase in total noncurrent restricted cash and investments of approximately \$175.6 million, an increase in restricted interest receivable of approximately \$1.5 million, and an increase in current restricted cash and investments of approximately \$45.3 million, less an increase for construction funds of approximately \$167.8 million, which must be subtracted because it is used to calculate net assets invested in capital assets, net of related debt.

Unrestricted net assets decreased by approximately \$3.5 million, from approximately \$28.4 million in 2004 to approximately \$24.9 million in 2005. This amount is the remainder of retained earnings after computing the value of net assets invested in capital assets, net of related debt and restricted net assets.

Total net assets increased by approximately \$6.6 million, from approximately \$51.1 million in 2004 to approximately \$57.7 million in 2005. The increase was a result of the change in net assets during 2005 from continuing operations. The change in net assets is described in further detail in the discussion of the Condensed Statements of Revenues, Expenses and Changes in Net Assets for 2005 and 2004.

## WISCONSIN PUBLIC POWER INC.

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The following table summarizes the changes in financial position for WPPI for the years ended December 31, 2005 and 2004:

#### Condensed Statements of Revenues, Expenses, and Changes in Net Assets for the Periods Ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>	<u>Dollar change</u>	<u>Percentage change</u>
Operating revenues	\$ 306,111,928	223,028,979	83,082,949	37.3%
Operating expenses	296,977,487	214,692,925	82,284,562	38.3
Operating income	9,134,441	8,336,054	798,387	9.6
Net investment income, equity in earnings of ATC, and unrealized loss on interest rate swap agreements	7,846,430	5,344,627	2,501,803	46.8
Interest expense and debt-related expenses	(10,920,999)	(9,989,948)	(931,051)	9.3
Other nonoperating expenses	(81,129)	(147,092)	65,963	(44.8)
Change in net assets before future recoverable costs	5,978,743	3,543,641	2,435,102	68.7
Future recoverable costs	650,610	556,359	94,251	16.9
Change in net assets	6,629,353	4,100,000	2,529,353	61.7
Net assets, beginning of year	51,113,300	47,013,300	4,100,000	8.7
Net assets, end of year	\$ 57,742,653	51,113,300	6,629,353	13.0

#### Operating Revenues

2005 was a year that saw rapidly rising purchased power costs, particularly in the second half of the year. As WPPI purchased more expensive power to meet member demand, revenues increased correspondingly with those costs as WPPI billed members for the cost of purchased power. Total operating revenues increased approximately \$83.1 million, or approximately 37.3%, from approximately \$223.0 million in 2004 to approximately \$306.1 million in 2005.

Included in operating revenues are sales to members, sales to others, and other income. All amounts have been rounded to the nearest \$0.1 million.

Sales to members increased approximately \$57.5 million, or approximately 29.2%, from approximately \$196.4 million in 2004 to approximately \$254.0 million in 2005. Megawatt hour sales to members increased approximately 7.8%, from 4,585,942 in 2004 to a total of 4,941,385 in 2005. New Members Juneau, New Glarus and Mt. Horeb accounted for approximately 2.0% of the megawatt hour increase, with the remaining 5.8% increase in megawatt hours attributable to requirements from existing members. Approximately \$42.0 million, or approximately 21.3%, of the increased revenue was attributable to billing for higher purchased power costs to serve members.

## **WISCONSIN PUBLIC POWER INC.**

### Management's Discussion and Analysis

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There was no Rate Stabilization Fund use in 2005, whereas approximately \$3.0 million was utilized in 2004 to offset in part the cost of replacement power purchased during an unplanned outage at Boswell 4.

Sales to others increased approximately \$28.4 million, or approximately 124.8%, from approximately \$22.8 million in 2004 to approximately \$51.2 million in 2005. Sales of generation into the Midwest Independent System Operator Day 2 Market totaled approximately \$27.0 million, and accounted for the bulk of the increase. These sales occurred after the start of the Day 2 Market on April 1, 2005. Total sales to other customers accounted for the remaining approximately \$1.8 million increase in sales to others.

Other income increased approximately \$0.1 million driven primarily by an increase in revenue from the Worthington Wind Turbines of approximately \$0.1 million.

#### **Operating Expenses**

Total operating expenses increased approximately \$82.3 million, or approximately 38.3%, from approximately \$214.7 million in 2004 to approximately \$297.0 million in 2005. The increase in operating expenses was driven primarily by the higher purchased power costs.

Purchased power expense, which includes purchased power and transmission expenses, increased approximately \$64.7 million, or approximately 35.7%, from approximately \$181.2 million in 2004 to approximately \$245.9 million in 2005. The purchased power expense portion of this line item increased approximately \$61.6 million, or approximately 38.4%, from approximately \$160.2 million in 2004 to approximately \$221.8 million in 2005, primarily due to higher fuel prices. The transmission expense portion of this line item increased by approximately \$3.1 million, or approximately 15.0%, from approximately \$20.9 million in 2004 to approximately \$24.0 million in 2005, primarily due to an increase in rates.

Fuel expense increased approximately \$16.6 million, from approximately \$8.5 million in 2004 to approximately \$25.1 million in 2005. Part of the increase was attributable to WPPI's Boswell 4 and South Fond du Lac Units 1 and 4 returning to normal levels of operation in 2005, after experiencing unplanned outages that necessitated major repairs in 2004. Fuel expense was approximately \$18.0 million in 2003, which was a more typical year of operations. The additional increase in 2005 over the 2004 and 2003 levels was attributable to higher costs for natural gas.

Other power production expense decreased by approximately \$0.3 million, or approximately 6.0%, from approximately \$5.3 million in 2004 to approximately \$4.9 million in 2005. The reduction reflected lower maintenance costs at Boswell 4 and South Fond du Lac Units 1 and 4 due to the extensive maintenance performed in 2004.

Administrative and general expense increased by approximately \$0.5 million, or approximately 4.2%, from approximately \$11.3 million in 2004 to approximately \$11.8 million in 2005. Salary and benefits made up approximately 59% of all administrative and general expense. Those categories increased by approximately 7.3% in 2005 over 2004 due to an increase of 2 staff members, increases in salaries, and health insurance premium increases of approximately 19.5%.

Depreciation and amortization expense increased approximately \$0.6 million, from approximately \$6.0 million in 2004 to approximately \$6.6 million in 2005. The increase was due primarily to the Island Street Peaking Plant being in operation for all of 2005—the plant was operational as a new plant for May through December of 2004.

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### Management's Discussion and Analysis

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Island Street depreciation increased approximately \$0.4 million. Boswell 4 had an increase of approximately \$0.1 million, and other WPPI generation units accounted for the remaining approximately \$0.1 million increase.

Tax expense increased approximately \$0.1 million, from approximately \$2.5 million in 2004 to approximately \$2.6 million in 2005. The increase was a result of the Island Street Peaking Plant being in operation for all 12 months of 2005, after being operational as a new plant for only a partial year in 2004.

#### **Nonoperating Revenues (Expenses)**

Investment income increased approximately \$1.9 million, from approximately \$2.2 million in 2004 to approximately \$4.1 million in 2005. The majority of the increase was from the reinvestment of the 2005 A and B bond proceeds for the last two months of 2005. Reinvestment of bond proceeds increased investment income approximately \$1.6 million in 2005. The investment income from the bond proceeds is being used to fund the construction of Elm Road Generating Station Units 1 and 2, and pay for a portion of capitalized interest during construction of the units, as outlined in the plan of finance for the units. The remaining approximately \$0.3 million in increased investment income was attributable to WPPI investment activities. WPPI maintains a laddered portfolio of investments to maximize interest earnings. A portion of the total investments is scheduled to mature each year. In 2005, WPPI was able to reinvest the proceeds from matured investments at higher interest rates than those funds had previously been invested in, which generated additional investment income over the investment income in 2004.

Equity in earnings of ATC (American Transmission Company) increased by approximately \$0.8 million, from approximately \$4.2 million in 2004 to approximately \$5.1 million in 2005. WPPI maintains an ownership share of approximately 5.2%. WPPI's equity in the earnings of ATC increased in 2005 as a result of higher earnings at ATC during 2005 compared with 2004.

Unrealized loss on interest rate swap agreement increased by approximately \$0.1 million, from approximately \$0.8 million in 2004 to approximately \$0.9 million in 2005. The unrealized loss is the net result of mark to market calculations for WPPI's three floating to fixed rate swaps.

WPPI's 2003B transaction, which had an original notional amount of \$65.7 million, had a notional amount of \$65.1 million at the end of 2005. The fair value of this swap increased approximately \$0.6 million, from approximately negative \$1.2 million in 2004 to approximately negative \$0.6 million in 2005.

WPPI's 2003C transaction, which had an original notional amount of \$39.35 million, had a notional amount of \$37.925 million at the end of 2005. The fair value of this swap increased approximately \$0.3 million, from approximately \$0.9 million in 2004 to approximately \$1.2 million in 2005.

WPPI's 2005B transaction, which had an original notional amount of \$93.9 million, had a notional amount of \$93.9 million at the end of 2005. The fair value of this swap was recorded for the first time in 2005 at approximately negative \$1.9 million.

The net result of marking the three swap transactions to market as of December 31, 2005 was the recognition of an unrealized loss of approximately \$0.9 million in 2005.

Net decrease in fair value of investments increased by approximately \$0.1 million, from approximately \$0.3 million in 2004 to approximately \$0.4 million in 2005. WPPI has an investment policy of purchasing highly

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rated investments and holding them to maturity. The investment portfolio is structured in a laddered format to have investments of varying maturity dates.

Interest expense increased approximately \$1.1 million, from approximately \$7.9 million in 2004 to approximately \$9.0 million in 2005. The increase was due to interest expense of approximately \$1.8 million on WPPI's Series 2005 A and B bonds, which were issued on November 2, 2005 to fund the Elm Road Generating Station construction project. This amount was offset by a slight decline in interest expense on WPPI's Series 2003 A, B and C issues due to scheduled retirement of bond principal, and approximately \$0.5 million in allowance for funds used during construction attributable to the Elm Road Generation Station construction.

Amortization of debt related costs decreased by approximately \$0.1 million, from approximately \$2.1 million in 2004 to approximately \$2.0 million in 2005. The decrease was in accordance with amortization schedules for the Series 2003 A, B and C debt related costs.

#### **Future Recoverable Costs**

Future recoverable costs increased approximately \$0.1 million, from approximately \$0.6 million in 2004 to approximately \$0.7 million in 2005. Future recoverable costs is a calculation designed to ensure that rate payers are not charged for both depreciation on an asset and principal payments on the bonds issued to acquire the asset in the same year. The calculation ensures that the combination of interest payments, principal payments, and depreciation expense are leveled over the life of an asset. In that manner, rates to pay for the asset are relatively level from year to year. In the early years of an asset, the calculation will result in an addition to income and assets. As principal is retired, the calculation will result in a reduction to income and a reduction in the accrued asset. WPPI added new debt service accruals in 2005 for the 2005A and 2005B bonds, resulting in an increase in future recoverable costs of approximately \$0.1 million.

#### **Change in Net Assets**

Change in net assets increased by approximately \$2.5 million, from \$4.1 million in 2004 to approximately \$6.6 million in 2005. The change is the net result of revenues and other income minus expenses and other costs as described in the sections above.

Total net assets at the end of 2005 were approximately \$57.7 million, up from approximately \$51.1 million at the end of 2004.

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**Financial Changes in 2004 from 2003**

The following table summarizes the financial position of WPPI as of December 31, 2004 and 2003:

**Condensed Balance Sheets**

Assets	2004	2003	Dollar change	Percentage change
Capital assets, net of accumulated depreciation	\$ 129,727,892	127,825,548	1,902,344	1.5%
Noncurrent assets	82,119,841	86,179,456	(4,059,615)	(4.7)
Deferred costs	27,171,118	23,834,684	3,336,434	14.0
Current assets	44,639,286	53,661,048	(9,021,762)	(16.8)
Total assets	<u>\$ 283,658,137</u>	<u>291,500,736</u>	<u>(7,842,599)</u>	(2.7)
<b>Liabilities and Net Assets</b>				
Long-term debt	\$ 158,273,732	162,034,567	(3,760,835)	(2.3)
Rate stabilization	35,127,846	37,694,606	(2,566,760)	(6.8)
Other deferred credits and liabilities	11,168,980	16,489,572	(5,320,592)	(32.3)
Current liabilities	27,974,279	28,268,691	(294,412)	(1.0)
Total liabilities	<u>232,544,837</u>	<u>244,487,436</u>	<u>(11,942,599)</u>	(4.9)
Net assets:				
Invested in capital assets, net of related debt	(30,460,234)	(47,255,272)	16,795,038	(35.5)
Restricted	53,218,725	61,219,993	(8,001,268)	(13.1)
Unrestricted	28,354,809	33,048,579	(4,693,770)	(14.2)
Total net assets	<u>51,113,300</u>	<u>47,013,300</u>	<u>4,100,000</u>	8.7
Total liabilities and net assets	<u>\$ 283,658,137</u>	<u>291,500,736</u>	<u>(7,842,599)</u>	(2.7)

Total assets decreased approximately \$7.8 million primarily due to decreases in restricted cash and investments of approximately \$9 million related to use of reserve fund monies. Approximately \$6.0 million was spent for repairs and major maintenance related to a stator ground fault in the generator of Boswell Energy Center Unit 4 and cracked turbine blades in South Fond du Lac Combustion Turbine 1. \$1.7 million of this amount came from WPPI's Self-Insurance Fund, and approximately \$4.3 million from WPPI's Renewal & Replacement Fund was utilized to perform accelerated maintenance during the outages in addition to required repairs. Approximately \$3.0 million from WPPI's Rate Stabilization Fund was used to offset relatively high replacement power costs while those generating units were out of service.

Total liabilities decreased by a total of approximately \$11.9 million. Outstanding long-term debt was reduced by approximately \$3.8 million as a result of scheduled debt service payments. Current liabilities decreased by approximately \$300,000 as a result of normal fluctuations in short-term liabilities such as Accounts Payable. Rate Stabilization reserves decreased by approximately \$2.5 million as a result of the approximately \$3.0 million use of the fund described above, followed by a partial replenishment of approximately \$450,000 at year-end.

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Other deferred credits and liabilities decreased by approximately \$5.6 million due primarily to utilization of Self-Insurance and Renewal & Replacement funds as described above.

Net assets of WPPI totaled approximately \$51.1 million at the close of 2004, an increase of \$4.1 million from the prior year. This increase was after WPPI took charges against earnings of \$1,180,000 to replenish its Renewal & Replacement Fund and \$950,000 to replenish its Self-Insurance Fund after their utilization during 2004, and deferred revenue of approximately \$450,000 to partially replenish the Rate Stabilization Fund after utilization during 2004. Including the year-end deferral, the total amount in the Rate Stabilization Fund was approximately \$35.1 million on December 31, 2004.

At the close of 2000, WPPI used available funds to invest \$16.9 million in the newly created American Transmission Company (ATC). This investment, which is accounted for using the equity method, had increased to approximately \$27 million at the end of 2004. The Board of Directors adopted a resolution on December 18, 2003 that included designation of \$8.65 million in proceeds from a contract settlement to be used for future capital investment in ATC. Approximately \$5 million of those designated funds was invested in ATC during 2004. On December 16, 2004, the Board of Directors adopted a resolution that included designation of \$4.1 million of 2004 Net Income for future investment in ATC. Both of these designations are part of an overall plan to maintain WPPI's ownership share of ATC at approximately 5.5%. Each capital contribution converts current assets of cash into a noncurrent asset, but does not otherwise affect WPPI's balance sheet. Quarterly equity dividends are recorded as part of Net Income, which increases the amount of noncurrent assets and net assets on the balance sheet at year end. Dividends are accrued monthly as an increase in equity, with a subsequent reduction in the value of the investment when the cash portion of the dividend is paid out each quarter. ATC retains approximately 20% of its net earnings each year, WPPI's share of which is credited to WPPI's capital account.

WPPI's cost to decommission its share of Boswell Unit 4 is projected to be approximately \$4.8 million in 2024, assuming an annual inflation rate of 3%. The majority of the estimated decommissioning cost of the coal-fired plant is related to the ash ponds. Prior to 2003, WPPI recorded approximately \$1.4 million as a decommissioning liability and set aside funds in its Decommissioning Fund. In 2003, WPPI adopted Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations*. To ensure that sufficient funds are accumulated and that these costs are equitably distributed to customers, level funding of the remaining estimated decommissioning liability began in 1996. The Decommissioning Fund had assets of approximately \$1.8 million at the end of 2004.

The Self-Insurance Fund was established to cover uninsured losses at WPPI's generating plants and other potential uninsured losses. The generating plants are covered by insurance, including property and boiler and machinery policies, with substantial deductibles. Deductibles equal \$1 million per occurrence on the Boswell Energy Center Unit 4 coal plant, with 20% of that amount (\$200,000) being the responsibility of WPPI. South Fond du Lac Combustion Turbine Units 1 and 4 each have deductibles of \$1.5 million per occurrence, with WPPI being responsible for 100% of the costs. The Island Street Peaking Plant has a deductible of \$500,000 per occurrence, with WPPI being responsible for 100% of the costs. On December 12, 2003, South Fond du Lac Unit 1 sustained significant damage when a compressor blade snapped during turbine operation. The cost to repair the damage exceeded the insurance deductible of \$1.5 million. The deductible was paid utilizing the monies in the Self-Insurance Fund. On February 6, 2004, Boswell Energy Center Unit 4 incurred a ground fault in the stator of the generator. Repairs to the unit exceeded the \$1.0 million insurance deductible. WPPI paid for its 20% share of the deductible

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utilizing monies in the Self-Insurance Fund. These actions reduced the Self-Insurance Fund from approximately \$3.7 million to approximately \$2.0 million. In light of these losses, on December 16, 2004, the Board of Directors approved a charge against 2004 earnings of \$950,000 to bring the balance of the Fund up to approximately \$3.0 million, which is an amount sufficient to cover simultaneous events at the plants with the largest deductibles—South Fond du Lac Unit 1 and Unit 4.

The outages required to repair Boswell Unit 4 and South Fond du Lac Unit 1 were also utilized to accelerate scheduled major maintenance that would otherwise have required separate unit shutdowns at a later date. This allowed the units to resume operation with all damage repaired and a state of maintenance that should increase their availability over the next 8–10 years. The accelerated maintenance was paid for utilizing the Renewal & Replacement Fund. South Fond du Lac Unit 4 also received accelerated major maintenance during 2004 to bring it to an equivalent state of readiness to South Fond du Lac Unit 1. Utilization of the Renewals & Replacements Fund for accelerated maintenance on Boswell Unit 4 and South Fond du Lac Units 1 and 4 reduced the Renewals & Replacements Fund from approximately \$9.5 million on December 31, 2003 to a level of approximately \$2.3 million. On December 16, 2004 the Board of Directors approved a charge against 2004 earnings of \$1,180,000 to partially replenish the Renewals & Replacements Fund. The same amount will be budgeted for deposit each year through 2014 to provide for scheduled major maintenance.

In 1992, the Board of Directors changed its policy to allow members' equity (net assets) to grow only by the 10% coverage in excess of debt service each year. Any revenues yielding coverage in excess of 110% of debt service were deferred to the Rate Stabilization Fund. In 1997, the prospect of major changes in the industry, including possible deregulation, prompted the Board of Directors to add a 3% margin to member rates to build the Rate Stabilization Fund, with collections beginning in 1998 and ending at the close of 2002. Subsequently, the Board chose to extend the collections through 2003. The collections were adjusted slightly in 2000, with only revenues received from the 3% margin being deferred rather than all revenues yielding debt service coverage in excess of 110%. In December of 2003, the Board of Directors discontinued the 3% collection and instead set rates for 2004 to recover debt service coverage of 145% rather than 110%. This change had no material effect on rates. The Board will annually decide the disposition of any earnings from debt service coverage collections over 110% of debt service. Such funds may be used for further investments in the American Transmission Company, deposits in the Rate Stabilization Fund, or other purposes. Four members that joined WPPI in 2001 and 2002 must make additional payments for deposit to the Rate Stabilization Fund equal to what they would have contributed had they been members in 1998–2002. These collections added \$634,585 to the Rate Stabilization Fund in 2004 and \$629,557 to the Rate Stabilization Fund in 2003. Approximately \$1.1 million in additional payments remain to be made. These members are all on track to complete their additional deposits to the Rate Stabilization Fund by the middle of 2006.

Debt service coverage collections before final Board deferrals of revenue or charges against earnings totaled 150.3% of debt service in 2004. On December 16, 2004 the Board adopted a resolution on the disposition of 2004 earnings that included four components. A charge against earnings of \$1,180,000 was made to partially replenish the Renewal & Replacement Fund and put the fund on a path to pay for projected major maintenance over the next 10 years. A charge against earnings of \$950,000 was made to increase the balance of the Self Insurance Fund. \$4,100,000 was retained as net income and designated for future investment in the American Transmission Company. Any remaining earnings after those items were to be deposited in the Rate Stabilization Fund to partially replenish it after the use of approximately \$3.0 million during 2004. As a result, \$449,839 in deferred revenue was deposited in the Rate Stabilization Fund, resulting in a balance of \$35,127,846 as of

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December 31, 2004. After those actions, final debt service coverage for 2004 is 132.5%, above the 110% coverage amount required by WPPI's Bond Resolution.

Most capital expenditures, other than major construction projects, are funded through current rates charged to members. A majority of the projected costs of scheduled major maintenance outages are collected through rates in advance of the scheduled outage. In 2004, major maintenance was performed on Boswell Energy Center Unit 4 and South Fond du Lac Unit 1 at the same time as the units were out of service due to aforementioned breakdowns. WPPI's 20% share of major maintenance at Boswell 4 was approximately \$600,000, in addition to the \$200,000 insurance deductible paid from the Self-Insurance Fund. Major maintenance performed on South Fond du Lac 1 in 2004 totaled approximately \$3.5 million in addition to the \$1.5 million insurance deductible paid from the Self-Insurance Fund. South Fond du Lac Unit 4 also had major maintenance work done during 2004 to prevent a possible turbine blade failure of the type experienced by Unit 1. Approximately \$2.6 million of major maintenance was performed on South Fond du Lac Unit 4.

To meet a portion of its long-term capacity needs, WPPI installed a new 52 megawatt combustion turbine in Kaukauna, WI that began commercial operation on May 15, 2004. Initial costs of approximately \$2.2 million incurred in 2002 for the Kaukauna combustion turbine project were paid with available funds in 2002 and reimbursed with proceeds of the 2003A Power Supply System Revenue Bonds. The project was completed using proceeds of the 2003A Power Supply System Revenue Bonds. At the end of 2004, the total cost of the project, which was completed in 2004, was approximately \$25.0 million.

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The following table summarizes the changes in financial position for WPPI for the years ended December 31, 2004 and 2003:

**Condensed Statements of Revenues, Expenses, and Changes in Net Assets for the Periods Ended December 31, 2004 and 2003**

	<u>2004</u>	<u>2003</u>	<u>Dollar change</u>	<u>Percentage change</u>
Operating revenues	\$ 223,028,979	221,267,276	1,761,703	0.8%
Operating expenses	<u>214,692,925</u>	<u>207,462,818</u>	<u>7,230,107</u>	3.5
Operating income	8,336,054	13,804,458	(5,468,404)	(39.6)
Net investment income, equity in earnings of ATC, and unrealized gain (loss) on interest rate swaps	5,344,627	5,920,130	(575,503)	(9.7)
Interest expense and debt-related expenses	(9,989,948)	(9,483,620)	(506,328)	5.3
Other nonoperating expenses	<u>(147,092)</u>	<u>(59,233)</u>	<u>(87,859)</u>	148.3
Change in net assets before future recoverable costs and cumulative effect of change in accounting principle	3,543,641	10,181,735	(6,638,094)	(65.2)
Future recoverable costs	<u>556,359</u>	<u>221,680</u>	<u>334,679</u>	151.0
Change in net assets before cumulative effect of change in accounting principle	4,100,000	10,403,415	(6,303,415)	(60.6)
Cumulative effect of change in accounting principle	<u>—</u>	<u>312,837</u>	<u>312,837</u>	100.0
Change in net assets	4,100,000	10,716,252	(5,990,578)	(55.9)
Net assets, beginning of year	<u>47,013,300</u>	<u>36,297,048</u>	<u>10,716,252</u>	29.5
Net assets, end of year	<u><u>\$ 51,113,300</u></u>	<u><u>47,013,300</u></u>	<u><u>4,100,000</u></u>	8.7

Sales to members for 2004 increased 10.3% over 2003, coming in at approximately \$196.4 million versus \$178.1 million in the prior year. The increase in revenues from sales to members from 2003 to 2004 is attributable to an increase in rates to members of 4.1% over 2003 rates, compounded by an increase in total megawatt hours sold.

Total 2004 revenue of approximately \$223.0 million amounted to a 0.8% increase over 2003 revenue of approximately \$221.3 million. Overall revenue did not grow in proportion to member sales growth due to a decline in sales to others. Generation repairs at Boswell Unit 4 and South Fond du Lac Units 1 and 4 did not

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### Management's Discussion and Analysis

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allow sales of excess power to others for a significant part of 2004. As a result, sales to others for 2004 of approximately \$22.8 million were 26.7% lower than the 2003 total of approximately \$31.1 million.

Purchased power increased to approximately \$181.2 million in 2004 from approximately \$164.2 million in 2003, reflecting the purchase of replacement power for the periods when the aforementioned WPPI generating units were out of service, and also reflecting increased fuel costs, particularly for natural gas, for WPPI's major suppliers of purchased power.

Fuel expense was approximately \$9.6 million less in 2004 than 2003. The drop in this expense category was also directly attributable to the repair and major maintenance outages at WPPI generating units. Because the units were not producing electricity for significant periods of 2004, less fuel was used in 2004 compared to 2003.

Other power production expense is composed solely of the expenses of Boswell Unit 4 and South Fond du Lac Units 1 and 4. To avoid the significant rate impacts that overhauls of the South Fond du Lac units would cause, maintenance expenses are accrued for each megawatt-hour generated by the South Fond du Lac units in addition to an annual fixed accrual. These accruals are included in other power production expense and the funds are set aside in the Renewals & Replacement Fund. Both Boswell Unit 4 and South Fond du Lac Units 1 and 4 produced fewer megawatt hours in 2004 compared to 2003, resulting in a drop in other power production expense to approximately \$5.3 million in 2004 from approximately \$6.8 million in 2003.

Tax expense was approximately \$595,000 higher in 2004 than in 2003. Property tax expense accrued on Boswell Unit 4 was approximately \$390,000 more in 2004 than 2003, and in-lieu-of-property-tax payments on the new Island Street Peaking Plant in Kaukauna, WI were approximately \$265,000, while in-lieu-of-property-tax payments on South Fond du Lac Units 1 and 4 were approximately \$60,000 lower in 2004 compared to 2003.

Other income returned to a more typical level of approximately \$800,000 in 2004 compared to 2003 when approximately \$12.0 million was received due to over \$11.0 million in one-time revenues from the negotiated buyout of a power supply contract in the amount of \$8.65 million plus approximately \$2.4 million in one-time refunds received from power and transmission providers as a result of litigation.

Administrative and general expenses increased approximately 3.6% compared to 2003. The increase was due primarily to the rising cost of health insurance along with annual increases in employee compensation, plus expenses associated with preparing for the Midwest Independent System Operator Electricity Market scheduled to begin on April 1, 2005.

Interest expense increased by approximately \$343,000 compared to 2003, as a result of fluctuations in the interest rates for the 2003B and 2003C floating to fixed rate swaps. These rates are synthetically fixed, which means the net interest will fluctuate slightly around a base level during the year based on the market rates for 35 day auction rate debt and the one month London Inter Bank Offering Rate (LIBOR). Overall interest expense is approximately \$3.0 million less than would otherwise have been incurred as a result of the refinancing and defeasance of higher rate fixed rate debt accomplished in 2003.

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The 2003B swap had an original notional amount of \$65,700,000 which is reduced each year by principal retirement. WPPI pays short-term 35 day auction rate interest to buyers of 35 day securities sold in an amount equal to the outstanding principal of the notional amount, and pays the swap counterparty a fixed rate of 3.355%. WPPI receives interest earnings equal to 67% of the one-month LIBOR rate from the counterparty. For 2004, the effective net interest rate on the 2003B bonds averaged 3.69%. The termination date of the swap is July 1, 2021.

The 2003C swap had an original notional amount of \$39,350,000, which is reduced each year by principal retirement. WPPI pays short-term 35 day auction rate interest to buyers of 35 day securities sold in an amount equal to the outstanding principal of the notional amount, and pays the swap counterparty a fixed rate of 2.805%. WPPI receives interest earnings equal to 67% of the one-month LIBOR rate from the counterparty. For 2004, the effective net interest rate averaged 3.11%. The termination date of the swap is July 1, 2023.

In 1999, the Board of Directors declared \$1,025,000 surplus under the bond resolution and funded an employee retention plan. Since that time the amount set aside for the plan has been increased by \$567,967.25. On an accounting basis, retention plan benefit expenses are being accrued as employees earn the benefits. Accrued retention plan benefit expenses were approximately \$200,000 in 2004 and \$300,000 in 2003.

#### **Contact Information**

This financial report is designed to provide a general overview of WPPI's finances. Questions or requests for additional information should be addressed to the VP Corporate Services, 1425 Corporate Center Drive, Sun Prairie, WI 53590.

**WISCONSIN PUBLIC POWER INC.**

Balance Sheets

December 31, 2005 and 2004

<b>Assets</b>	<b>2005</b>	<b>2004</b>
Capital assets:		
Electric plant and equipment	\$ 209,011,996	208,917,656
Accumulated depreciation and amortization	<u>(85,331,589)</u>	<u>(79,247,568)</u>
Electric plant and equipment, net	123,680,407	129,670,088
Construction work in progress	<u>28,694,373</u>	<u>57,804</u>
Total capital assets	<u>152,374,780</u>	<u>129,727,892</u>
Noncurrent assets:		
Restricted cash and investments	223,971,151	48,345,733
Investments	657,941	6,557,361
Investment in ATC	32,257,900	26,975,087
Receivables from members	<u>20,021</u>	<u>241,660</u>
Total noncurrent assets	<u>256,907,013</u>	<u>82,119,841</u>
Deferred costs:		
Unamortized bond issuance costs, net of accumulated amortization of \$643,156 and \$401,448 in 2005 and 2004, respectively	5,868,639	2,589,393
Future recoverable costs	20,981,802	20,331,191
Other deferred charges	<u>3,123,836</u>	<u>4,250,534</u>
Total deferred costs	<u>29,974,277</u>	<u>27,171,118</u>
Current assets:		
Cash and investments	18,160,697	15,085,838
Restricted cash and investments	51,291,535	5,950,766
Receivables:		
Power sales accounts receivable	27,596,797	17,762,864
Other	348,944	2,467,746
Unrestricted interest receivable	319,436	433,256
Restricted interest receivable	<u>1,490,653</u>	<u>18,439</u>
Total receivables	29,755,830	20,682,305
Inventories	3,387,184	2,586,520
Prepayments	<u>366,562</u>	<u>333,857</u>
Total current assets	<u>102,961,808</u>	<u>44,639,286</u>
Total assets	<u>\$ 542,217,878</u>	<u>283,658,137</u>

See accompanying notes to financial statements.



**WISCONSIN PUBLIC POWER INC.**

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Operating revenues:		
Sales to members	\$ 253,960,043	196,421,285
Rate stabilization	—	3,016,600
Sales to others	51,226,690	22,777,895
Other income	925,195	813,199
Total operating revenues	<u>306,111,928</u>	<u>223,028,979</u>
Operating expenses:		
Purchased power	245,870,163	181,170,782
Fuel	25,081,903	8,458,159
Other power production	4,945,772	5,261,339
Administrative and general	11,815,072	11,334,693
Depreciation and amortization	6,641,731	5,998,809
Taxes	2,622,846	2,469,143
Total operating expenses	<u>296,977,487</u>	<u>214,692,925</u>
Operating income	<u>9,134,441</u>	<u>8,336,054</u>
Nonoperating revenues (expenses):		
Investment income	4,140,803	2,157,289
Equity in earnings of ATC	5,061,484	4,230,530
Unrealized loss on interest rate swap agreements	(945,856)	(783,668)
Net decrease in fair value of investments	(410,001)	(259,524)
Interest expense, net	(8,950,930)	(7,911,689)
Amortization of debt-related costs	(1,970,069)	(2,078,259)
Other	(34,625)	(29,500)
Loss on disposal of assets	(46,504)	(117,592)
Total nonoperating expenses, net	<u>(3,155,698)</u>	<u>(4,792,413)</u>
Change in net assets before future recoverable costs	5,978,743	3,543,641
Future recoverable costs	650,610	556,359
Change in net assets	6,629,353	4,100,000
Total net assets, beginning of year	<u>51,113,300</u>	<u>47,013,300</u>
Total net assets, end of year	<u>\$ 57,742,653</u>	<u>51,113,300</u>

See accompanying notes to financial statements.

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Statements of Cash Flows

Years ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Cash flows from operating activities:		
Cash receipts from members and others	\$ 299,302,372	217,614,831
Cash payments for purchased power	(243,235,656)	(181,437,294)
Cash payments for fuel	(25,171,824)	(8,373,551)
Cash payments for operations and management	(4,506,138)	(3,651,529)
Cash payments for payroll and ad valorem taxes	(2,619,890)	(2,506,210)
Cash payments to employees	(5,261,750)	(4,844,036)
Cash payments for administrative and general	(7,303,424)	(6,278,845)
Net cash provided by operating activities	<u>11,203,690</u>	<u>10,523,366</u>
Cash flows from noncapital financing activities:		
Cash payments for other nonoperating expenses	<u>(34,625)</u>	<u>(29,500)</u>
Cash flows from investing activities:		
Investments purchased	(244,016,037)	(51,507,406)
Investment in ATC	(4,100,592)	(5,025,966)
Investments sold	56,025,022	42,954,143
Investment income	2,882,185	1,939,217
Cash distributions received from ATC	3,879,264	3,223,876
Cash receipts from notes	5,488	15,137
Net cash used in investing activities	<u>(185,324,670)</u>	<u>(8,400,999)</u>
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(26,462,390)	(15,904,835)
Bond issuance costs paid	(3,520,954)	—
Bond premium proceeds	5,229,624	—
Proceeds from issuance of new debt	236,920,000	—
Proceeds from line of credit	6,500,000	—
Principal paid	(5,600,000)	(7,985,000)
Interest paid	(8,367,534)	(8,291,454)
Net cash provided by (used in) capital and related financing activities	<u>204,698,746</u>	<u>(32,181,289)</u>
Increase (decrease) in cash and cash equivalents	30,543,141	(30,088,422)
Cash and cash equivalents, beginning of year	<u>36,109,173</u>	<u>66,197,595</u>
Cash and cash equivalents, end of year	\$ <u>66,652,314</u>	\$ <u>36,109,173</u>
Reconciliation of operating income to net cash flows from operating activities:		
Operating income	\$ 9,134,441	8,336,054
Noncash item included in operating income:		
Depreciation and amortization	6,641,731	5,998,809
Changes in assets and liabilities:		
Receivables	(7,502,656)	(3,651,302)
Inventories	(800,664)	21,913
Prepayments	(32,705)	(97,122)
Accounts payable and other current liabilities	1,247,964	2,711,345
Deferred credits and other liabilities	1,510,205	222,839
Other deferred charges	1,005,374	(3,019,170)
Net cash provided by operating activities	\$ <u>11,203,690</u>	\$ <u>10,523,366</u>

As of December 31, 2005 and 2004, WPPI held \$259,686,910 and \$66,805,612, respectively, of investments considered to be noncash equivalents.

See accompanying notes to financial statements.

## WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2005 and 2004

### (1) Summary of Significant Accounting Policies

#### (a) *Organization and Operations*

Wisconsin Public Power Inc. (WPPI) is a municipal electric company and political subdivision of the State of Wisconsin, formed in 1980. The purpose and function of WPPI is to provide an adequate, economical, and reliable wholesale supply of electricity to its members for distribution by the members' electric utilities to their retail customers. WPPI is owned by its member municipalities, which govern its policies. WPPI had 40 members as of December 31, 2005.

WPPI sells power to its members under power sales contracts that remain in effect until December 31, 2037. Under the contracts, WPPI has agreed to sell and deliver to each member, and each member has agreed to take and pay for its electric power requirements, with certain exceptions related to existing member-owned hydroelectric facilities and other specified generation. Also, from time to time, WPPI sells capacity and energy at market prices to other entities.

In addition to its power supply program, WPPI offers various services to members that are intended to enable members to operate their electric systems more efficiently. The services include rate analyses, rate comparisons, computer network support, large-customer billing, equipment testing, joint purchasing of equipment and supplies, joint arrangements for disposal of hazardous waste, and various energy- and customer-related programs.

WPPI supplies the power requirements of its members from a mix of resources, including an undivided 20% ownership in the 535 MW Boswell Unit 4 coal-fired steam unit near Grand Rapids, Minnesota; two 84 MW combustion turbine units near Fond du Lac, Wisconsin; a 54 MW combustion turbine in Kaukauna; member generation under contract to WPPI; and power purchases from other entities. Minnesota Power owns the remaining interest in Boswell Unit 4 and is the operating agent responsible for operation and maintenance of the unit. WPPI's undivided ownership interest in Boswell Unit 4 is included in capital assets. WPPI pays 20% of the total cost to operate and maintain Boswell Unit 4. South Fond du Lac Units 1 and 4 are two of the four combustion turbine units located on a site owned by Alliant Energy (Alliant). Alliant owns the other two units on the site and operates and maintains the units owned by WPPI. WPPI compensates Alliant for these services. Construction was completed on the Kaukauna combustion turbine in 2004. WPPI owns the unit, and Kaukauna Utilities operates it. WPPI compensates Kaukauna Utilities for operating and maintaining the combustion turbine. The member generation under contract to WPPI consists of a number of small generating units, totaling approximately 37 MW of capacity. The remainder of WPPI's power requirements is purchased from other entities.

#### (b) *Basis of Presentation/Chart of Accounts*

The financial statements are prepared on the accrual basis of accounting, in conformity with U.S. generally accepted accounting principles, including the application of Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*, as the statement relates to the deferral of revenues and expenses to future periods in which the revenues are earned or the expenses are recovered through the rate-making process. WPPI uses the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission (FERC).

## WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2005 and 2004

WPPI complies with all applicable pronouncements of the Governmental Accounting Standards Board (GASB). In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. WPPI also complies with the pronouncements of the Financial Accounting Standards Board that do not conflict with GASB pronouncements.

**(c) *Use of Estimates in the Preparation of Financial Statements***

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

**(d) *Capital Assets***

Additions to and replacements of capital assets are recorded at original cost, including allowance for borrowed funds if acquired with tax-exempt debt. Depreciation is recorded using the straight-line method using service lives of 2 to 35 years.

**(e) *Restricted Cash and Investments***

WPPI's bond resolution requires the segregation of bond proceeds and prescribes the application of WPPI's revenues. Amounts classified as restricted cash and investments on the balance sheets represent cash and investments whose use is restricted by the bond resolution.

**(f) *Unamortized Bond Issuance Costs***

Bond issuance costs are amortized over the repayment period of the related issues using a method that approximates the effective-interest method.

**(g) *Future Recoverable Costs***

Revenues from members include amounts to pay bond principal and interest. For financial reporting purposes, WPPI recognizes depreciation and amortization pertaining to fixed assets and other assets financed by bond principal. As allowed through the application of the provisions of SFAS No. 71, future recoverable costs represent the difference between depreciation and amortization of assets financed with bond proceeds and the related principal recovered in rates in the present period. These costs will be recovered in future periods when the principal amounts exceed the related depreciation and amortization.

**(h) *Other Deferred Charges***

Other deferred charges primarily represent costs associated with the buyout of WPPI's obligations under capacity purchase agreements with two of its members. As allowed through the application of SFAS No. 71, such effects have been deferred and are being amortized for rate-making purposes over the original terms of the capacity purchase agreements, which expire in 2007 and 2009, respectively.

**WISCONSIN PUBLIC POWER INC.**

Notes to Financial Statements

December 31, 2005 and 2004

**(i) Cash Equivalents**

For purposes of the statements of cash flows, cash equivalents are cash and investments having an initial maturity of three months or less when purchased.

**(j) Power Sales Accounts Receivable**

Power sales accounts receivable, representing power sales to members for the period between the last billing date and the end of the period, are accrued in the period sold.

**(k) Inventories**

Inventories include fuel and repair parts. They are charged to plant or operation and maintenance expense at average cost when used. Inventories are valued at the lower of average cost or fair value.

**(l) Rates**

Rates are reviewed and adopted by WPPI's board of directors annually. Under the bond resolution, WPPI's rates are expected to yield net revenues for an annual period equal to at least 1.10 times the aggregate debt service for that period. Rates are not subject to state or federal regulation.

Beginning in 2004, in December of each year the board of directors determines how to distribute the margin above 110%. As allowed through the application of the provisions of SFAS No. 71, the margin may be deposited in the Rate Stabilization Fund and is also reported as deferred credits on the accompanying balance sheet to be distributed in future years as revenues in the statement of revenues, expenses, and changes in net assets to cover costs that otherwise would be recovered through its rates to members. For the years ended December 31, 2005 and 2004, \$628,831, and \$449,840, respectively, was deferred and added to the Rate Stabilization Fund. In 2004, \$3,016,600 of the Rate Stabilization Fund was used to curb the impact of major outages and recognized as revenue.

**(m) Taxes**

WPPI is exempt from federal, Wisconsin, and Minnesota income taxes as a political subdivision of the State of Wisconsin. Tax expense includes Minnesota property taxes, Wisconsin payments-in-lieu-of-ad valorem taxes, payroll-related taxes, and emission fees.

**(n) Vacation and Sick Leave**

Under terms of employment, employees are granted one day of sick leave per month. Employees are paid annually for any sick leave accrued in excess of 1,080 hours. Accrued sick leave is not paid to employees when they leave employment.

Employees are allowed to accumulate up to five days of vacation pay. Employees are paid annually for any accrued vacation in excess of five days. In extraordinary circumstances, the chief executive officer may allow an employee to accumulate additional vacation pay. Accrued vacation is not considered material; therefore, no liability is recorded.

## WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2005 and 2004

**(o) *Operating Revenues and Expenses***

Operating revenues result from exchange transactions associated with the principal activity of WPPI, the sale of electricity. Reported operating revenues are affected by the contributions to or distributions from the rate stabilization account. Operating expenses are defined as expenses directly related to, or incurred in support of, the provision of electricity and other services to the members. All other expenses are classified as nonoperating expenses.

**(p) *Fair Value of Financial Instruments***

The carrying amount of WPPI's cash and cash equivalents, receivables, and accounts payable approximates fair value because of the short maturities of these instruments. Investments are carried at fair value based on quoted market prices. The fair value of WPPI's long-term debt is estimated by discounting future cash flows using interest rates that approximate those that could currently be obtained by WPPI. The fair value of long-term debt as of December 31, 2005 and 2004 is approximately \$413 million and \$190 million, respectively.

**(q) *Reclassifications***

Certain 2004 financial statement amounts have been reclassified to conform with the 2005 presentation.

**(r) *New Accounting Pronouncements***

In March 2003, the Governmental Accounting Standards Board (GASB) issued Statement No. 40, *Deposit and Investment Risk Disclosures – an amendment of GASB Statement No. 3*. WPPI implemented Statement No. 40 during the year ended December 31, 2005. As a result of implementing this statement, WPPI revised the deposit and investment risks disclosures in note 2 to include disclosure of credit risk, concentration of credit risk, and interest rate risk.

In November 2003, the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This Statement establishes accounting and financial reporting standards for impairment of capital assets. WPPI will implement Statement No. 42 beginning with the year ending December 31, 2006. WPPI is currently evaluating the impact of adopting Statement No. 42.

**WISCONSIN PUBLIC POWER INC.**

Notes to Financial Statements

December 31, 2005 and 2004

**(2) Deposits and Investments**

WPPI's bond resolution requires the segregation of bond proceeds and establishment of various funds, and prescribes the application of WPPI's revenues. Also, it defines what type of securities WPPI may invest in. Funds consist principally of cash, money market funds, repurchase agreements, investments in the LGIP, treasury notes, agencies, treasury strips, and corporate bonds. The fund's purposes and balances are summarized below:

<b>Fund</b>	<b>Held by</b>	<b>Purpose</b>
Construction	Trustee	To provide for the acquisition and construction of the power supply system.
Debt Service	Trustee	To accumulate principal and interest associated with each bond series.
Debt Service Reserve	Trustee	To establish a reserve equal to the largest principal and interest payment that would have to be made in any one year during the remaining life of the bonds.
Revenue	WPPI	To accumulate revenues and to provide for the payment of expenses and for disposition of revenues to various funds.
Renewal & Replacement	WPPI	To provide a reserve to be applied to the payment of the costs of renewals, replacements, and repairs to the power supply system.
Self-Insurance	WPPI	To provide a reserve to be applied to the payment of claims and losses arising from hazards and risks to the extent that the insurance required to be maintained does not cover such claims or losses.
Rate Stabilization	WPPI	To accumulate revenues which will be used to reduce rates in a future period.
Decommissioning	WPPI	To accumulate funds to pay for the eventual costs of decommissioning, retirement, or disposal of major facilities.

**WISCONSIN PUBLIC POWER INC.**

Notes to Financial Statements

December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
Restricted cash and investments:		
Noncurrent:		
Debt service reserve accounts	\$ 16,938,383	8,130,135
Renewal & Replacement Fund	5,895,010	2,260,369
Self-Insurance Fund	3,084,255	2,078,805
Rate Stabilization Fund	35,425,534	33,736,915
Decommissioning	2,290,767	2,139,509
Construction Fund	134,992,319	—
Debt Service Funds	25,344,883	—
Total noncurrent	<u>223,971,151</u>	<u>48,345,733</u>
Current:		
Construction Fund	33,900,980	1,096,213
Debt Service Funds	17,390,555	4,854,553
Total current	<u>51,291,535</u>	<u>5,950,766</u>
Total restricted cash and investments	<u>275,262,686</u>	<u>54,296,499</u>
Unrestricted cash and investments:		
Noncurrent:		
Investments	657,941	6,557,361
Investment in ATC	32,257,900	26,975,087
	<u>32,915,841</u>	<u>33,532,448</u>
Current cash and investments:		
Petty cash	300	300
Revenue Fund	18,160,397	15,085,538
	<u>18,160,697</u>	<u>15,085,838</u>
Total unrestricted cash and investments	<u>51,076,538</u>	<u>48,618,286</u>
Total cash and investments	<u>\$ 326,339,224</u>	<u>102,914,785</u>

WPPI's investments are potentially subject to various risks, including the following:

- **Custodial credit risk** – The risk that in the event of a failure of the counterparty to an investment transaction (typically a brokerage firm or financial institution), the government would not be able to recover the value of the investment or collateral securities.
- **Credit risk** – The risk than an issuer or other counterparty to an investment will not fulfill its obligations.

## WISCONSIN PUBLIC POWER INC.

### Notes to Financial Statements

December 31, 2005 and 2004

**Concentration risk** – Investing 5% or more of WPPI’s portfolio in the securities of a single issuer. This disclosure excludes U.S. Government Securities that are explicitly guaranteed by the U.S. government.

- **Interest rate risk** – The risk of potential variability in the fair value of fixed rate investments resulting from changes in interest rates (the longer the period for which an interest rate is fixed, the greater the risk). The weighted average maturity of the money market mutual funds is 60 days.

As of December 31, 2005, WPPI owned a portfolio of 58 individual investments consisting of 52 U.S. Government Agency securities and 6 corporate bonds. Fifty-one securities had maturities of three years or less. Seven securities were mortgage-backed securities that have monthly maturities, with final maturities ranging from 7.86 years to 18.16 years.

WPPI has a guaranteed investment contract with Morgan Stanley & Co. Inc. for capitalized interest bond proceeds for the 2005 A Debt Service Fund in the amount of \$21,583,805 as of December 31, 2005. Tranches of the funds are withdrawn semi annually in December and June of each year to make debt service payments. The final tranche of the investment is scheduled for withdrawal in June 2009.

WPPI has a guaranteed investment contract with Citigroup Global Markets Inc. for project bond proceeds for the 2005 A Construction Fund in the amount of \$102,916,623 as of December 31, 2005. Tranches of the funds are withdrawn monthly to make project payments. The final tranche of the investment is scheduled for withdrawal in December 2010.

WPPI has a guaranteed investment contract with Citigroup Global Markets Inc. for capitalized interest bond proceeds for the 2005 B Debt Service Fund in the amount of \$13,717,083 as of December 31, 2005. Tranches of the funds are withdrawn weekly to make debt service payments. The final tranche of the investment is scheduled for withdrawal in June 2010.

WPPI has a guaranteed investment contract with JP Morgan Chase Bank N.A. for project bond proceeds for the 2005 B Construction Fund in the amount of \$60,387,630 as of December 31, 2005. Tranches of the funds are withdrawn monthly to make project payments. The final tranche of the investment is scheduled for withdrawal in July 2010.

WPPI has an internal investment policy that stipulates its guidelines to help ensure safety of principal, liquidity, and diversification of its investment portfolio. Generally, permitted investments include U.S. government obligations, state and local government and corporate obligations rated in either of the two highest whole rating categories by a nationally recognized rating agency, guaranteed investment contracts, and money market mutual funds.

**WISCONSIN PUBLIC POWER INC.**

Notes to Financial Statements

December 31, 2005 and 2004

Cash and investments are summarized as follows as of December 31, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
U.S. government securities	\$ 43,250,249	46,122,338
Money market mutual fund	48,190,397	26,231,980
Guaranteed investment contracts	198,605,140	—
Corporate bonds	2,690,607	2,479,144
Mutual funds	<u>652,624</u>	<u>1,061,961</u>
	293,389,017	75,895,423
Investment in ATC	32,257,900	26,975,087
Deposits – cash	<u>692,307</u>	<u>44,275</u>
Total cash and investments	<u>\$ 326,339,224</u>	<u>102,914,785</u>

Deposits and investments in each bank are insured by the Federal Deposit Insurance Corporation (FDIC) in the amount of \$100,000 for interest-bearing accounts and \$100,000 for noninterest-bearing accounts. Deposits and investments are also insured for \$400,000 by the State Deposit Guarantee Fund (SDGF). However, due to the relatively small size of the SDGF in relation to the total deposits covered and other legal implications, recovery of material principal losses of the pool may not be significant to the utility.

Investments are stated at fair value, based on quoted market prices. Adjustments necessary to record investments at fair value are recorded in the statements of revenues, expenses, and changes in net assets.

**(3) Investment in American Transmission Company**

During 2000, WPPI purchased an equity interest in ATC Management Inc. and American Transmission Company LLC (collectively ATC). ATC is a for-profit, transmission-only company. It owns, plans, maintains, monitors, and operates electric transmission assets in portions of Wisconsin, Michigan, and Illinois. ATC began operations on January 1, 2001. At December 31, 2005 and 2004, WPPI's equity interest in ATC was approximately 5.2%. WPPI's investment in ATC qualifies for the equity method of accounting.

Under the terms of the ownership agreement with ATC, WPPI has the right, but not the obligation, to purchase additional member units in ATC as may from time to time arise in order to maintain its initial percentage interest in ATC, as well as participate in voluntary additional capital calls. At December 31, 2005, WPPI had outstanding commitments to fund ATC of approximately \$2,478,000. The amount was paid in January 2006.

**WISCONSIN PUBLIC POWER INC.**

Notes to Financial Statements

December 31, 2005 and 2004

Condensed financial data of ATC for 2005 and 2004 follows:

	<u>2005</u>	<u>2004</u>
	(In millions)	
Operating statement data:		
Revenues	\$ 296.0	262.5
Operating expenses	(166.6)	(157.7)
Other income	3.5	3.0
Net interest expense	(36.5)	(29.9)
Earnings before tax	<u>\$ 96.4</u>	<u>77.9</u>
Balance sheet data:		
Current assets	\$ 29.2	30.2
Noncurrent assets	<u>1,516.1</u>	<u>1,228.6</u>
Total assets	<u>\$ 1,545.3</u>	<u>1,258.8</u>
Current liabilities	\$ 140.5	192.3
Long-term debt	648.7	448.5
Other noncurrent liabilities	105.3	81.3
Members' equity	<u>650.8</u>	<u>536.7</u>
Total liabilities and members' equity	<u>\$ 1,545.3</u>	<u>1,258.8</u>

**WISCONSIN PUBLIC POWER INC.**

Notes to Financial Statements

December 31, 2005 and 2004

**(4) Capital Assets**

Capital asset activity for the years ended December 31, 2005 and 2004 was as follows:

<b>2005</b>	<b>Beginning balance</b>	<b>Additions</b>	<b>Transfers</b>	<b>Retirements</b>	<b>Ending balance</b>
Nondepreciable assets:					
Land	\$ 88,883	—	—	—	88,883
Construction work in progress	57,804	29,576,534	(939,965)	—	28,694,373
Total nondepreciable assets	<u>146,687</u>	<u>29,576,534</u>	<u>(939,965)</u>	<u>—</u>	<u>28,783,256</u>
Depreciable assets:					
Utility plant	208,828,773	50,250	939,965	(895,875)	208,923,113
Total depreciable assets	208,828,773	50,250	939,965	(895,875)	208,923,113
Accumulated depreciation and amortization	<u>(79,247,568)</u>	<u>(6,641,731)</u>	<u>—</u>	<u>557,710</u>	<u>(85,331,589)</u>
Depreciable assets, net	<u>129,581,205</u>	<u>(6,591,481)</u>	<u>939,965</u>	<u>(338,165)</u>	<u>123,591,524</u>
Capital assets, net	<u>\$ 129,727,892</u>	<u>22,985,053</u>	<u>—</u>	<u>(338,165)</u>	<u>152,374,780</u>
<b>2004</b>	<b>Beginning balance</b>	<b>Additions</b>	<b>Transfers</b>	<b>Retirements</b>	<b>Ending balance</b>
Nondepreciable assets:					
Land	\$ 88,883	—	—	—	88,883
Construction work in progress	18,130,457	15,900,333	(33,972,986)	—	57,804
Total nondepreciable assets	<u>18,219,340</u>	<u>15,900,333</u>	<u>(33,972,986)</u>	<u>—</u>	<u>146,687</u>
Depreciable assets:					
Utility plant	184,136,120	510,239	33,972,986	(9,790,572)	208,828,773
Total depreciable assets	184,136,120	510,239	33,972,986	(9,790,572)	208,828,773
Accumulated depreciation and amortization	<u>(74,529,912)</u>	<u>(5,998,809)</u>	<u>—</u>	<u>1,281,153</u>	<u>(79,247,568)</u>
Depreciable assets, net	<u>109,606,208</u>	<u>(5,488,570)</u>	<u>33,972,986</u>	<u>(8,509,419)</u>	<u>129,581,205</u>
Capital assets, net	<u>\$ 127,825,548</u>	<u>10,411,763</u>	<u>—</u>	<u>(8,509,419)</u>	<u>129,727,892</u>

In 2004, the combustion turbine gas generator project sited at Kaukauna, Wisconsin was completed. Capitalized interest of \$344,461 was included as a part of the cost of the project in 2004. The project was financed by internal funds and proceeds of the Series 2003A bond issue.

**WISCONSIN PUBLIC POWER INC.**

Notes to Financial Statements

December 31, 2005 and 2004

During 2004, WPPI repaired damages sustained at two of its generating facilities, Boswell Unit 4 and South Fond du Lac Unit 1. The costs of repair are included in capital asset additions. A corresponding reduction in capital assets equal to the cost of the repairs has also been included in capital asset retirements to adjust capital assets for the effects of these events.

Construction work in progress at December 31, 2005 consists primarily of the 8.33% interest in two 615 MW supercritical coal-fired generating units under construction in Oak Creek, Wisconsin. Capitalized interest of \$489,809 was included as part of the cost of the project in 2005. The project was financed by the proceeds of the Series 2005A and 2005B bond issues.

**(5) Long-Term Debt**

The following Power Supply System Revenue Bonds were issued to finance WPPI's acquisition and construction of utility plants:

	<u>2005</u>	<u>2004</u>
Revenue bonds:		
2003 Series A 3.00% to 5.25%		
Due July 1, 2004–2033	\$ 76,930,000	80,630,000
2003 Series B variable rate bonds		
Due July 1, 2004–2021	65,100,000	65,500,000
2003 Series C variable rate bonds		
Due July 1, 2004–2023	36,425,000	37,925,000
2005 Series A 4.625% to 5.00%		
Due July 1, 2001–2038	143,020,000	—
2005 Series B variable rate bonds		
Due July 1, 2012–2038	93,900,000	—
	<u>415,375,000</u>	<u>184,055,000</u>
Less current maturities	8,585,000	5,600,000
Unamortized discount, net	13,223,283	20,181,268
	<u>\$ 393,566,717</u>	<u>158,273,732</u>

The Power Supply System Revenue Bonds are secured by all funds and revenues of WPPI derived from the ownership and operation of its power supply system.

The unamortized discount/premium, which includes the unamortized difference between the reacquisition price and the net carrying amount of refunded debt issues, is amortized over the terms of the related bond issues using a method that approximates the effective-interest method.

During 2005, \$143,020,000 of the Power Supply System Revenue Bonds, Series 2005A, and \$93,900,000 Power Supply System Revenue Bonds, Series 2005B were issued to purchase an 8.33% interest in two 615 MW supercritical coal-fired generating units under construction in Oak Creek, Wisconsin.

A total of \$32,855,000 of defeased debt remained outstanding at December 31, 2005 from advance refundings entered into by WPPI.

**WISCONSIN PUBLIC POWER INC.**

Notes to Financial Statements

December 31, 2005 and 2004

Long-term liability activities for the years ended December 31, 2005 and 2004 were as follows:

<b>Long-term liabilities as of December 31, 2005</b>	<b>Beginning balance</b>	<b>Additions</b>	<b>Reductions</b>	<b>Ending balance</b>
Long-term revenue bonds	\$ 184,055,000	236,920,000	(5,600,000)	415,375,000
Less:				
Current maturities	5,600,000	8,585,000	(5,600,000)	8,585,000
Unamortized discount, net	<u>20,181,268</u>	<u>(5,229,623)</u>	<u>(1,728,362)</u>	<u>13,223,283</u>
Long-term revenue bonds, net	<u>\$ 158,273,732</u>	<u>233,564,623</u>	<u>1,728,362</u>	<u>393,566,717</u>
Deferred credits and other liabilities:				
Operating reserves and accrued liabilities	\$ 9,081,927	1,564,899	(900,693)	9,746,133
Rate stabilization	35,127,846	628,831	—	35,756,677
Asset retirement obligation	1,806,068	90,303	—	1,896,371
Fair value of interest rate swap agreements	<u>280,985</u>	<u>945,856</u>	<u>—</u>	<u>1,226,841</u>
Total deferred credits and other liabilities	<u>\$ 46,296,826</u>	<u>3,229,889</u>	<u>(900,693)</u>	<u>48,626,022</u>
<b>Long-term liabilities as of December 31, 2004</b>	<b>Beginning balance</b>	<b>Additions</b>	<b>Reductions</b>	<b>Ending balance</b>
Long-term revenue bonds	\$ 192,040,000	—	(7,985,000)	184,055,000
Less:				
Current maturities	7,985,000	—	(2,385,000)	5,600,000
Unamortized discount, net	<u>22,020,433</u>	<u>—</u>	<u>(1,839,165)</u>	<u>20,181,268</u>
Long-term revenue bonds, net	<u>\$ 162,034,567</u>	<u>—</u>	<u>(3,760,835)</u>	<u>158,273,732</u>
Deferred credits and other liabilities:				
Operating reserves and accrued liabilities	\$ 14,769,507	5,029,058	(10,716,638)	9,081,927
Rate stabilization	37,694,606	449,840	(3,016,600)	35,127,846
Asset retirement obligation	1,720,065	86,003	—	1,806,068
Fair value of interest rate swap agreements	<u>—</u>	<u>280,985</u>	<u>—</u>	<u>280,985</u>
Total deferred credits and other liabilities	<u>\$ 54,184,178</u>	<u>5,845,886</u>	<u>(13,733,238)</u>	<u>46,296,826</u>

## WISCONSIN PUBLIC POWER INC.

### Notes to Financial Statements

December 31, 2005 and 2004

Debt service payments on the outstanding bonds and the interest rate swap agreements (see note 6) are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 8,585,000	15,458,601	24,043,601
2007	6,085,000	17,336,075	23,421,075
2008	9,325,000	17,251,289	26,576,289
2009	6,755,000	16,648,919	23,403,919
2010	9,220,000	16,450,770	25,670,770
2011–2015	71,625,000	73,617,754	145,242,754
2016–2020	99,655,000	55,713,684	155,368,684
2021–2025	56,495,000	39,989,135	96,484,135
2026–2030	58,440,000	27,901,174	86,341,174
2031–2033	89,190,000	14,584,686	103,774,686
	<u>\$ 415,375,000</u>	<u>294,952,087</u>	<u>710,327,087</u>

#### (6) Interest Rate Swap Agreements

During 2005, WPPI entered into an interest rate swap agreement with JP Morgan Chase Bank N.A. and during 2003, WPPI entered into two interest rate swap agreements with Bear Stearns Capital Markets Inc. Interest rate swaps involve the contractual exchange of fixed- and floating-rate interest payment obligations based on a notional principal amount. WPPI entered into the interest rate swap agreements to achieve lower interest rates than would have been achieved by issuing traditional fixed rate debt. The interest rate swap agreement dated October 17, 2005 has a notional amount of \$93,900,000. The interest rate swap agreement dated February 6, 2003 has a notional amount of \$65,100,000. The interest rate swap agreement dated May 30, 2003 has a notional amount of \$36,425,000. WPPI is a receiver of floating-rate interest and a payer of a fixed-rate interest on all agreements. The fixed rates of interest were 3.5%, 3.355%, and 2.805%, respectively. As of December 31, 2005, the interest rate swaps had a combined negative fair value of \$1,226,841.

#### (7) Available Financing

During 2005, WPPI entered into a revolving line of credit agreement with a financial institution, which permits borrowings of up to \$10,000,000 and expires on May 31, 2006. Interest accrued on the unpaid principal amount outstanding at a rate per annum equal to the applicable British Bankers' Association LIBOR rate for deposits in U.S. dollars and the prime rate minus 175 points. The interest rate was 5.37% at December 31, 2005. At December 31, 2005, there was \$6,500,000 outstanding on the line of credit.

#### (8) Significant Members

Two significant members of WPPI accounted for \$63,780,091 and \$49,489,096 or approximately 20.9% and 22.5% of total sales revenues for the years ended December 31, 2005 and 2004, respectively.

**WISCONSIN PUBLIC POWER INC.**

Notes to Financial Statements

December 31, 2005 and 2004

**(9) Employee Benefits**

**(a) Retirement Plan**

WPPI has a Simplified Employee Pension-Individual Retirement Account (SEP-IRA) covering all of its employees funded through contributions by WPPI to an investment firm. The total contributions to the plan for the years ended December 31, 2005 and 2004 were \$564,623 and \$546,206, respectively.

**(b) Retention Plan**

In 1999, WPPI established an employee retention plan. The plan will make payments to specific employees after three, five, and eight years of continuing employment. Plan benefit expenses of \$105,227 and \$189,601 were accrued during 2005 and 2004, respectively. Total plan expenses in years one through eight of the program are expected to be approximately \$1.83 million.

**(10) Commitments**

WPPI has various long-term capacity and energy purchase contracts with various power suppliers. Capacity purchases for 2005 and 2004 totaled approximately 643 and 650 MW, respectively. WPPI does not own any transmission facilities and takes service for all of its transmission requirements under contracts and tariffs approved by FERC.

During 2005, WPPI entered into a series of agreements that establish WPPI's rights to an 8.33% interest in two 615 megawatt supercritical coal-fired generating units (the Project). Except under the limited circumstances as specifically provided within the agreements, WPPI may not terminate its participation or withdraw from the Project. Absent these circumstances or events, WPPI's financial obligation for its participation is approximately \$205 million. As of December 31, 2005, WPPI has paid approximately \$24.4 million of this commitment, with the remainder expected to be requested through 2010.

**(11) Risk Management**

WPPI is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors and omissions; workers' compensation; and healthcare of its employees. The generating plants are covered by insurance, including property and boiler and machinery policies, with deductibles. Deductibles equal 200,000 per occurrence on Boswell Unit 4, \$1.5 million per occurrence for the South Fond du Lac units, and \$500,000 per occurrence on the Kaukauna combustion turbine. Other risks are covered through the purchase of commercial insurance, with minimal deductibles.

WPPI maintains assets in the Self-Insurance Fund described in note 2 to be applied to the payment of claims and losses arising from hazards and risks to the extent that insurance does not cover such claims or losses. In December 2003, South Fond du Lac Unit 1 was damaged as a result of a mechanical failure. Costs of repair not covered by insurance are expected to be paid from the Self-Insurance Fund. Additions to the self-insurance liability in 2005 and 2004 pertain to this event.

**WISCONSIN PUBLIC POWER INC.**

Notes to Financial Statements

December 31, 2005 and 2004

Following is the activity for the self-insurance liability for the years ended December 31, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Self-insurance liability, beginning of year	\$ 2,875,017	3,567,011
Additions, representing interest	117,246	58,006
Additions	—	950,000
Usage	—	(1,700,000)
Self-insurance liability, end of year	\$ <u>2,992,263</u>	<u>2,875,017</u>